THE FISCAL IMPACT OF FEDERALISM
IN THE UNITED STATES

THE FISCAL IMPACT OF FEDERALISM IN THE UNITED STATES

BY

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To the memory of
Reta N. Maxwell

PREFACE

Books on public finance, even when written by Americans, have been singularly impervious to the significance of federalism. The existence of an extra layer of governments in the form of states is, indeed, often indicated, only to be casually dropped out of sight. Possibly the deficiency can be explained by the fact that the significance of federalism is to be found in a no man's land unoccupied by public finance, political science, or constitutional law. Or possibly the explanation is that, in fiscal terms, federalism was not always important. Concerning small things public finance, like the law, could be silent. Up to the twentieth century the sphere of government in the United States was relatively limited. The federal government and the state governments, engaged in limited functions and utilizing sources of revenue which were fairly separate, had little occasion for mettlesome jostling. Little conflict arose, and dissensions between them tended to focus on broad questions of the proper agenda of government as a whole, rather than of the proper agenda for particular levels of government.

This happy time has passed. The agenda of government have greatly expanded, federal and state governments do jostle, and therefore the question of what level of government is to act has become of vital consequence. And yet public discussion of the particular fiscal issues which have arisen has not been satisfactory. In Canada and Australia, which are also federal countries, greater intellectual progress has been made. Beyond a doubt thinking in these countries was stimulated because of the more severe impact of the fiscal problems of federalism during the great depression. Neither Canada nor Australia has the economic strength of the United States; in both of them government plays a much more dominant role in economic affairs; in both of them foreign trade is enormously more important than in the United States. These factors—to mention only a few—forced their federal governments into action, and at the same time and by the same token they made it imperative that the problems of intergovernmental relations be squarely faced. The outbreak of war

hastened the operation of these forces. In Canada and Australia the federal governments have taken over completely the field of income taxation, and although this step was avowedly only for the duration of the war, the prospect of reversion *status quo ante bellum* is remote.

No precise parallels in federal–state fiscal relations between these two federal countries and the United States should be anticipated. A similarity in trends is, however, likely to occur and the trend toward a greater federal power is preëminently visible.

Such a trend has been a manifest phenomenon in our recent history, and the presidential campaign of 1944 washed up for debate a great many federal–state issues for the consideration of the voters. Some of these were strictly of constitutional and political significance—the federal ballot for soldiers was one example. Others, notably the issue of federal aid, come under discussion in this volume. Behind many of the arguments of those who, in this debate, pose as the advocates of states' rights lies the implicit assumption that every move toward centralization is an overt conspiracy. And it is all too obvious that an attempt has been and will be made to use states' rights as a weapon to block federal action which is obnoxious to conservative groups.

This is a dangerous and misleading doctrine. It is the thesis of this volume that American federalism has fiscal problems for which outright centralization is no cure. States' rights, properly defined, have a genuine meaning, and only by cool consideration of them can our governmental machinery be so arranged as to cope with the job which lies ahead. But states' rights should not be twisted to mean opposition to every governmental change. Changes must be made, and a rigid resistance can in the long run only be injurious to the success of federalism. What is needed is the means for developing successful coöperation and integration between the federal government and the states in handling common governmental problems. This is the generalization—or platitude—which must be elaborated and explored.

In the following pages some of the material is new; some of it is merely a crystallization of specialized research done by others. Indeed, experts in each of the main topics examined in my chapters may feel that important matters have been left out or lightly treated. And in covering a wide range of material I have doubt-

less made mistakes. What has, I hope, been brought out is the significance of our federal structure. Put colloquially, my thesis is that federalism is "different."

In carrying out my research I gratefully acknowledge the aid given by the Guggenheim Foundation which awarded me a Guggenheim Fellowship in 1940, and by Clark University which granted me a leave of absence. My manuscript was nearly completed by the time this country entered the war, when work on it was suspended because of my employment in Washington. In the last few months the manuscript has been revised in the hope that it might be of some use in the current consideration of federal–state fiscal relations.

My extensive debt to previous writers in the field of federal–state fiscal relations can be expressed here only by a blanket acknowledgement. Special recognition should, however, be given to Lieutenant Eugene E. Oakes, U.S.N.R., on leave from Yale University, and Haskell P. Wald of the Department of Commerce, who read my manuscript and submitted excellent suggestions for its improvement. Mrs. Margaret N. Balcom prepared the charts and the statistical material which is presented in the conclusion. Her assistance in these, and in many matters of detail, was unsparing.

J. A. Maxwell

June, 1945

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CHAPTER I

PROLOGUE

In contemplating the causes which may disturb our union it occurs as matter of serious concern that any ground should have been furnished for characterizing parties by geographical discriminations—*Northern, Southern, Atlantic* and *Western*—whence designing men may endeavor to excite a belief that there is a real difference of local interests and views. . . . You cannot shield yourselves too much against the jealousies and heart-burnings which spring from these. *Washington's Farewell Address.*

WHEN the American colonies broke with Great Britain they were not ready for a strong federal union. Their population, scattered over a vast area, was not homogeneous in economic interests, political institutions, or religion. Within regions, as distinct from colonies, there was, indeed, more cohesion. The Southern colonies were bound together by slavery and by the importance in their economic life of tobacco and indigo; the Middle Atlantic colonies produced foodstuffs; New England looked to external commerce and to fishing. This economic regionalism stood as a barrier to a national union.

Against these elements making for separatism, other influences pulled the colonies together. A common language, law, and tradition were, with minor exceptions, the heritage of all. The growth of intercolonial trade after 1754 was rapid, and the colonies, by building roads and by improving their postal system, recognized their mutual interests. In time of crisis, they had joined together in protecting their frontiers, and after 1754 they drew together in common enmity against Great Britain.

How these centripetal and centrifugal forces would have balanced had the mother country been prepared to allow the colonies to develop complete self-government, nobody can know. In fact this course was not followed, and in 1774 the colonies were sufficiently cohesive to join in a loose association. But not until July 1776 did a committee of the second Continental Congress report a scheme of confederation. For a year and a half thereafter Congress debated the scheme, and a further three and a half years

elapsed before the Articles of Confederation were ratified by all the thirteen states. When independence had been won, not a few Europeans, and even some Americans, anticipated that the confederation would fall apart. Perhaps this danger was exaggerated, but in any event *improvement* in the scheme of government was to be very difficult to secure.

THE FEDERAL GOVERNMENT SECURES STRONG FISCAL POWERS

It was inevitable that the finances of the revolting colonies during the war should fall utterly into disorder. Taxation had always been light, and external commerce, the easiest source of revenue for immature governments, was dislocated by the war. Revolutionary assemblies were not likely to impose, or a people in revolt against authority to pay, heavy taxes. A Rhode Island protest which said that "taxation, or contribution for the support of the government, ought to be free and voluntary" [1] expressed a typical attitude. Even when taxes were levied, they were inefficiently collected; and people seeing their neighbors escape were provoked to evasion.

The ratification in 1781 of the Articles of Confederation, while establishing a national government, did not improve the public finances. The functions placed in the hands of the Congress were not inconsiderable; the lack was in the power, particularly the fiscal power, to administer them. For its revenue Congress was left in complete dependence upon the states. The states, at the call of the Congress, were to levy taxes through their own officers "in proportion to the value of all land within each state, granted to or surveyed for any Person, as such land and the buildings and improvements thereon shall be estimated according to such mode as the United States in Congress assembled, shall from time to time direct and appoint." [2] Every schoolboy knows how badly this worked. From 1781 to 1789 Congress ordered the states to pay as requisitions $6,630,000 in specie and $8,733,000 in indents; it received $3,384,000 in specie and $1,542,000 in indents.[3] The public lands were given to the gov-

[1] W. G. Sumner, *The Financier and Finances of the American Revolution* (New York, 1891), I, 18.

[2] Article VIII.

[3] C. J. Bullock, *Finances of the United States, 1775–1789* (Madison, 1895), p. 162.

ernment of the confederation by the Articles, but actual cession was slow. Interest on domestic and foreign debt fell into arrears, and the ability to borrow nearly vanished. So impotent was Congress and so great was the aversion to taxation in the states that the nation seemed close to an inflation which would wipe out all war debt.

The first attempts to strengthen the fiscal power of Congress were blocked. Rhode Island in 1781 refused to give Congress the right to levy a 5 per cent duty on imports—and amendment of the Articles required unanimous consent. In 1783 Congress asked for the right to levy a limited range of duties on imports for twenty-five years, the duties to be collected by state officers and to be used only to pay interest on the public debt. By 1787 twelve of the states signified acceptance of this innocuous measure, but New York was recalcitrant. Meanwhile, the states had begun to levy tariffs—sometimes to raise a revenue, sometimes to encourage state trade, and sometimes in retaliation for duties imposed by a neighbor. Against these divisive forces all men of property, and all those who desired a strong and united nation, prepared to move.

Nothing seemed clearer than that Congress needed the power to levy taxes of its own, but the power actually given by the new Constitution in 1788 went far beyond the proposals mentioned above. Congress received the power "to lay and collect taxes, duties, imposts and excises . . . ,"[4] which meant that, besides the exclusive control over customs, it was to have a concurrent jurisdiction with the states in practically all fields of taxation. To many contemporaries this seemed excessive, and the advocates of the plan, while insisting that such a broad federal power was desirable, protested that there was no practical likelihood of its extended use. Thus Hamilton argued that "the sense of the people, the extreme hazard of provoking the resentment of the State governments, and a conviction of the utility and necessity of local administration for local purposes, would be a complete barrier against the oppressive use of such a power."[5] He went on to affirm that, with the sole exception of duties on foreign trade, the states would retain an independent right to raise reve-

[4] Article I, Section VIII.
[5] *Federalist*, edited by Henry Cabot Lodge (New York, 1888), p. 185.

nue "in the most absolute and unqualified sense; and that an attempt on the part of the national government to abridge them in the exercise of it would be a violent assumption of power, unwarranted by any article or clause of its Constitution." [6] Why, then, was it needful to *give* the national government such a broad power? Because upon it fell the duty of defense. Wars and rebellions were the "two most mortal diseases of society." The expenditures of the national government, if it were blessed by peace, would be small. But since the danger of war was incalculable, the federal power of taxation should not be limited. Even to separate out and divide federal and state sources of revenue would be to sacrifice "the great *interests* of the Union to the *power* of the individual States." [7]

Hamilton had his way, and certainly he was right. But the forecast has been fulfilled of those who declared that, given this extended power of taxation, federal exercise would follow. For sixty years any extension of the federal revenue beyond customs was gingerly handled. Then, under stress of emergency, came a great surge forward with no reversion to the former position.

The other fiscal provisions of the Constitution can be passed over lightly. Congress was given the power to levy "direct" taxes, but only by apportioning them among the states "according to their respective numbers." [8] What was a direct tax? The Constitution did not say. When, by judicial interpretation, it turned out that important taxes—notably the income tax—were direct, this provision limited the federal taxing power. The reason was that apportionment according to population placed an undue burden upon the states with a low per capita wealth. Another provision of the Constitution prohibited levy of export duties. Behind this lay the fear of the South that its staple

[6] *Ibid.*, p. 186.

[7] *Ibid.*, p. 200. Hamilton's opinion of what should be state functions is given in the following quotation: "The expenses arising from those institutions which are relative to the mere domestic policy of a state, to the support of its legislative, executive and judicial departments, with their different appendages, and to the encouragement of agriculture and manufactures (which will comprehend almost all the objects of state expenditure), are insignificant in comparison with those which relate to the national defence." *Ibid.*, p. 197.

[8] This was a carry-over from the Articles of Confederation by which Congress could impose taxes upon the states according to the value of their lands and buildings.

exports might be taxed. In a few other features the Constitution bears evidence of sectional apprehensions, but these need not be discussed here.

Consolidation of Federal Power during the First Quarter-century

When at last the United States had a national government with adequate fiscal power, everyone watched eagerly to see how that power would be used. Urgent tasks had to be undertaken at once, but any solution of them was bound to raise up latent regional animosities.

At no time in the history of the United States was governmental debt—federal and state—so serious a problem as in 1789. The federal debt, foreign and domestic, was estimated at $54,124,500, of which $14,670,300 was arrears of interest. About the proper method for handling the foreign portion of the debt ($11,710,400) there was little dispute: it should be settled according to the letter of the contract. About the domestic debt, however, no such unanimity prevailed. Many people felt that some distinction should be drawn between original holders of the securities and the speculators who had acquired them by recent purchase. Against the proposal of discrimination Hamilton took a forthright position. The securities had been issued as negotiable so that the holder could sell them in the market and the buyer could be safe in his purchase. That contract should not be broken. Hamilton stressed also the practical difficulties in the way of effective discrimination. How trace back the various holders of a security and how ascertain the motives behind sale and purchase? His own simple plan of outright federal assumption would, he conceded, permit some individuals to make speculative profits; but this damage was irreparable, and to strive after would not be to secure a more exact justice. Here again Hamilton had his way.[9]

Even more controversial was the question of state debts, amounting to $18,271,800.[10] These also were war debts—they

[9] But some alteration in the contract was made by funding. Upon the United States domestic debt, interest at 6 per cent was paid only upon two-thirds of the principal; upon the remaining one-third of the principal interest began after ten years. Upon arrears of interest, interest was paid at the rate of 3 per cent.

[10] Hamilton estimated them at $21,500,000, but this amount was not assumed.

were "the price of liberty"—and Hamilton argued for federal assumption. All public creditors, in his opinion, should be treated alike, as they would not be if the states were left to their own resources. The states were unequal in the debts which they had amassed and in their ability to carry these debts. All of them, however, had been deprived of customs, and therefore of their chief source of revenue. The federal government, equipped with this revenue, could assume the debts without great inconvenience.

For weeks the question was savagely debated. On several occasions assumption was voted down only to be revived in another form. At this same time Congress was deadlocked also on the issue of the permanent location of the national capital; and finally the two chief antagonists, Hamilton and Jefferson, made a bargain. Hamilton secured a few votes in support of the new city of Washington; Jefferson secured a few in favor of assumption. And although speculation in the state debts was even more greedy and deplorable than that in the federal debt, assumption was a wise step.[11]

It is not generally realized that, for the first decade, the fiscal position of the federal government appeared far from being secure. When in 1790 Hamilton made his report on the public credit, he estimated that, out of a total annual expenditure of $2,839,200, nearly 80 per cent would be required to service the public debt. For the first decade interest ate up 41 per cent of the federal revenue, a figure never approached in any subsequent period. The revenue rested almost entirely upon customs, and therefore upon foreign trade. What if the government became involved in war? This would disrupt collections and force borrowing in a narrow domestic market. Hamilton and his friends hoped to improve the fiscal position of the government by building up a system of internal revenue.[12] Something was done, and

[11] By the terms of the funding, interest upon four-ninths of the total principal was to begin at once, upon two-ninths after ten years, and upon three-ninths the rate was to be 3 per cent. A. S. Bolles, *Financial History of the United States, 1789–1860* (New York, 1885), II, 28.

[12] In a frank letter to Washington, Aug. 18, 1792, Hamilton stated the case for an excise system as follows: "Some able men thought it well to lay hold of so valuable a resource of revenue before it was generally preoccupied by the state governments. . . . They supposed that it was not amiss that the authority of the national government should be visible in some branch of internal revenue, lest a total non-exercise of it should beget an impression that it was never to be exercised. It was supposed, too, that a thing of this kind could not be introduced with

in the first decade excises produced about 8 per cent of the total revenue. But the expense of collection was high, and opposition was intense, the most dramatic display being the Whisky Rebellion in Western Pennsylvania.[13] One other fiscal resource was tried out, with results which indicated its slight value. In 1798 Congress apportioned a direct tax of $2,000,000 among the states. Collections came in very slowly. By the end of 1801 over one-third was uncollected, and the accounts were not closed until four years later.

It is, therefore, not surprising to find that at the end of the first decade contemporary observers were quite unimpressed with the fiscal progress which had been made. The Federalists, who had been in power, were unimpressed because what had been done fell short of their aims. The Republicans, morbidly afraid of centralization, were naturally unappreciative of the accomplishments of their opponents. In fact, the achievements were remarkable: a heavy war debt had been put in order, the state finances had been established on a sound basis, the federal revenue system had been enlarged. With the advantage of hindsight, we can see that the nation had been fortunate in the nature of governmental policies. Beyond question, the Republicans had a sounder perception of the perplexities of federalism than had Hamilton. But at the outset too great a sense of difficulty, too strict a regard for the feelings of the states, would have paralyzed action.[14] The Federalists, driven by the genius of Hamilton and buttressed by the

greater prospect of easy success than at a period when the government enjoyed the advantage of impressions, when State factions to resist its authority were not yet matured, when so much aid was to be derived from the popularity and firmness of the actual Chief Magistrate." *Complete Works,* edited by Henry Cabot Lodge (New York, 1885–86), II, 247–48.

[13] A petition from this area protested that a duty on spirituous liquors was immoral, "dangerous to liberty," and unequal, as "laid on the common drink of a nation." The petitioners were "apprehensive that this excise will by degrees be extended to other articles of consumption, until everything we eat, drink, or wear be, as in England and other European countries, subjected to heavy duties and the obnoxious inspection of a host of officers." Albert Gallatin, *Writings,* edited by Henry Adams (Philadelphia, 1879), I, 3.

[14] Fisher Ames, writing in March 1792, declared: "We hear incessantly from the old foes of the Constitution, 'This is unconstitutional and that is,' and indeed, what is not? I scarce know a point which has not produced this cry, not excepting a motion for adjournment. If the Constitution is what they [the Republicans] affect to think it, their former opposition to such a nonentity was improper. . . ." *Works of Fisher Ames* (Boston, 1854), I, 114–15.

decisions of John Marshall, established the power of the federal government over the forces of localism. By 1800, however, it was time for a change, and it was the great good fortune of the nation to secure an administration which, in the main, consolidated the positions occupied by the Federalists.

The next twelve years were to demonstrate the true fiscal strength of the federal government. The internal duties were abolished on the ground that it was wise to abstain from taxing "those subjects over which the individual states possess a concurrent right." [15] Yet the revenues continued to grow, and in 1808 Gallatin made the following optimistic statement: "The geographical situation of the United States, their history since the Revolution, and, above all, present events, remove every apprehension of frequent wars. It may, therefore, be confidently expected that a revenue derived solely from duties on importations, though necessarily impaired by war, will always be amply sufficient, during long intervals of peace, not only to defray current expenses, but also to reimburse the debt contracted during the few periods of war." [16] The Louisiana purchase, at a cost of $15,000,000, had been arranged in 1803 without the least financial difficulty, and both Jefferson and Gallatin began to think of federal projects which were Hamiltonian in scope. In his sixth annual message (1806), Jefferson favored federal expenditure on roads, rivers, and canals, because better methods of communication would obliterate "the lines of separation" among the states and cement the union "by new and indissoluble ties"; [17] and he suggested also the establishment of a national university. These steps were to be taken, however, only after "the constitutional enumeration of Federal Powers" had been augmented. Yet in earlier years expansion of the federal powers as such had seemed to be a Federalist doctrine.

Advancement of these schemes was halted first by the embargo and then by the War of 1812. Although the war policy as a whole was lamentably fumbling, the treasury showed that, on the administrative level, it had made progress. A series of excises, called explicitly war taxes and thus marked for prompt

[15] *American State Papers, Finance,* I, 734–35.

[16] *Report of the Secretary of the Treasury,* 1808 (vol. I, 1789–1814), p. 377.

[17] *Messages and Papers of the Presidents, 1789–1902,* edited by James E. Richardson (Washington, 1903), I, 409.

repeal, was imposed, and proved quite productive. Even the levy of three direct taxes was handled fairly well.

Growth of "Geographical Divisions"

Not long after the Treaty of Ghent, the forces of sectionalism, constrained within moderate limits by good fortune or design, began to gain new strength. The obvious force behind them was the geographic growth of the nation. A tide of settlement poured over the mountains, and between 1816 and 1821 the number of states grew from seventeen to twenty-three. These new areas were not wishful of extension of the federal authority; on the contrary, their people wanted freedom to pursue their own interests in their own way.

It is little short of remarkable how every president after Monroe, no matter what his party, harped on the responsibilities and dangers of federalism. John Quincy Adams had no fear of party squabbles over "speculative opinions" or "administrative policy." But, he declared, those "founded on geographical divisions, adverse interests of soil, climate and modes of domestic life are more permanent, and therefore, perhaps, more dangerous. It is this which gives inestimable value to the character of our Government, at once federal and national. It holds out to us a perpetual admonition to preserve alike and with equal anxiety the rights of each individual state in its own government and the rights of the whole nation in that of the Union." [18] The words of Andrew Jackson are similar: "That there are diversities in the interests of the different states which compose this extensive Confederacy, must be admitted." [19] Twenty-three years later, in 1853, Franklin Pierce evinced the deterioration in sentiment which had taken place. "It is evident," he said, "that a confederation so vast and so varied, both in numbers and in territorial extent, in habits and in interests, could only be kept in national cohesion by the strictest fidelity to the principles of the Constitution as understood by those who have adhered to the most restricted construction of the powers granted by the people and the States. . . . The minimum of Federal government compatible with the maintenance of national unity and efficient action in our

[18] *Messages and Papers of the Presidents,* II, 297: Inaugural Address, March 1, 1825.

[19] *Ibid.,* II, 513: Address, Dec. 6, 1830.

relations with the rest of the world should afford the rule and the measure of construction of our powers under the general clauses of the Constitution. A spirit of strict deference to the sovereign rights and dignity of every State . . . should characterize all our exercise of the respective powers temporarily vested in us as a sacred trust from the generous confidence of our constituents." [20]

At no time in the history of the United States did the touch of the federal government bear so lightly upon the citizens, at no time were its functions so light, as in the forty years before the Civil War. Although the problems of which the presidents spoke made it seem desirable that the federal government should do little, the overflowing condition of the treasury made it difficult for it to do little. Except for brief stretches the government had more revenue than it could easily spend; and, as a result, a philosophy of government which frowned upon extension of federal functions had to struggle against the temptations which a full treasury put before Congress. In 1826 a Senate committee spoke, without levity, of "the serious inconvenience of an overflowing Treasury." [21]

Let us glance hastily at the evidence. For a period of twenty-one years, 1816–1836, the treasury had surpluses in eighteen, and the three deficits were of insignificant amounts. By the early thirties the federal debt was practically extinguished, and Mr. McLane, the Secretary of the Treasury, could, in all candor, make the following report: "Seventeen years ago the country emerged from an expensive war, encumbered with a debt of more than 137 millions and in a comparatively defenceless state. In this short period it has promptly repealed all the direct and internal taxes which were imposed during the war, relying mainly upon revenue derived from imports and sales of the public domain. . . . The frontier has been extensively fortified, the naval and maritime resources strengthened, and part of the debt of gratitude to the survivors of the revolutionary war discharged. We have, moreover, contributed a large share to the general improvement, by the purchase of the valuable territory of Florida, and finally acquired the means of extinguishing the heavy debt in maintaining the late war, and all that remained of the debt of

[20] *Ibid.*, V, 224: Address, Dec. 5, 1853.

[21] *American State Papers* (Washington, 1832), V, 502.

the Revolution."[22] What was left to be done? Obviously the federal government might enlarge the scope of its expenditures, particularly by entering upon a system of internal improvements. Or, as another broad alternative, it might somehow cut down on its revenues by lowering the import duties, or by donating the public lands to the states, or by distributing federal revenues. Each of these propositions was debated at great length, but constitutional and sectional objections were not easy to overcome. Although the propositions are closely interrelated, it will be convenient to discuss first those to reduce the federal revenues.

The tariff history of this period is so familiar that little discussion is necessary. After 1824, although with some wavering, New England and the West joined the Middle Atlantic states in support of protection. The South, of course, was adamant in opposition, and the threat of nullification in 1832 brought home to Congress the gravity of the sectional cleavage. When the compromise tariff of 1833 was passed most people breathed more easily. Here was a scheme which would reduce the duties to modest levels and which might, by 1842, solve the problem of the surplus. In the middle 1830's this tariff was regarded "as a sort of temporary appendix to the Constitution."[23] For the time being most people were unwilling to touch the tariff.

Reduction of the federal revenues by donation of all or part of the public lands, or the revenue from them, was less sacrosanct. In 1832 Clay pushed a bill through Congress[24] which distributed the proceeds from the sales of public lands among the states in proportion to their federal representation in Congress (with the restriction that these proceeds should be used for internal improvements or for education). The bill was vetoed by Jackson, who stressed unconstitutionality. The lands had been ceded to the federal government for the common benefit of all the states, and they could not, therefore, be alienated to secure particular benefits. The bill, moreover, appropriated federal revenue for objects of a local nature and made for national supremacy over the states. "It appears to me," he said, "that a more direct road to consolidation cannot be devised. Money is power, and in that

[22] *Report of the Secretary of the Treasury*, 1831 (1829–36 volume), pp. 222–23.

[23] E. G. Bourne, *The History of the Surplus Revenue of 1837* (New York, 1885), p. 18.

[24] Roy M. Robbins, *Our Landed Heritage, the Public Domain, 1776–1936* (Princeton, 1942), pp. 55–58.

Government which pays all the public officers of the States will all political power be substantially concentrated." Congress should not be "the tax gatherer and paymaster" of the state governments.[25] Other proposals encountered other objections, all cloaked in the garb of unconstitutionality, but in reality the product of sectionalism. Distribution of the *proceeds* of the sales appealed to the northeastern states because they would get most of the proceeds; but it did not appeal to the southern states, which feared that the loss of this federal revenue would mean a higher tariff, or to the western states, which desired outright cession of the lands to them.

Distribution of the Surplus

A proposal more general in scope than distribution of the proceeds from the public lands was that the *surplus* federal revenue be given to the states. This had the advantage of being a less irrevocable alienation of the federal revenue, and to some people it seemed less subject to the blight of unconstitutionality. At one time—1829—even so strict a constructionist as Andrew Jackson favored distribution, although by 1836 he had changed his mind.[26]

Ultimately, in 1836, Congress did pass the distribution measure which has been criticized by so many historians. We should, however, appreciate the background. By 1835 the last remnant of the federal debt had been paid off, and the world was presented with the unique spectacle of a national government with a budget unburdened by interest charges. The revenue was derived from a moderate tariff which, by existing legislation, was becoming still more moderate, and from sales of public lands at a low price. Yet the revenue which flowed in was too abundant. Increased federal expenditure was no solution. Enlargement of the *scope* of federal expenditures would encounter a presidential veto, and it would arouse state jealousies. Within the limited range of sub-

[25] *Messages and Papers of the Presidents,* III, 67: Dec. 4, 1833.

[26] *Ibid.,* II, 452: Dec. 8, 1829. In a message of Dec. 5, 1836, Jackson stated the doctrine of financial responsibility in unqualified fashion: "If the necessity of raising taxes be taken from those who make the appropriations and thrown upon a more distant and less responsible set of public agents, who have the power to approach the people by an indirect and stealthy taxation, there is reason to fear that prodigality will soon supercede those characteristics which have thus far made us look with so much pride and confidence to the state governments as the mainstay of our Union and liberties." *Ibid.,* p. 244.

jects regarded as appropriate, federal expenditure was extravagant rather than deficient, and further increase was undesirable. Investment of the surplus revenue was not practicable. The only available securities were those of the states, and to select them would involve invidious comparisons and would provide bad investments.[27] This was the set of circumstances which made distribution appear attractive. Such a step would empty the federal treasury and it would relieve the many states which, at this time, were spending heavily for internal improvements.

The distribution act of 1836 had many peculiar features. It provided for apportionment among the states, according to their federal representation and in four quarterly installments, of the surplus revenue in the treasury on January 1, 1837.[28] But since outright distribution might bring a presidential veto, the sums were explicitly declared to be on deposit; and the Secretary of the Treasury was given certificates which the states were to be obligated to meet if the treasury was in need of funds. It was an open secret that all of this was a false front, and yet President Jackson glossed over his reluctance to sign the bill by pretending that the deposits were genuine and by asserting that to use them as gifts would be a "violation of public faith and moral obligation." [29]

On January 1, 1837, the sum of $37,469,000 was available and three quarterly distributions, totaling $28,100,000, were made. Before the third installment the nation had been stricken by depression. Almost all banks suspended, the government revenue shrank, and the treasury was rapidly emptied. President Van Buren called Congress in special session in May, and, after long debate, deposit of the fourth installment of the surplus was postponed until January 1, 1839.[30] In fact it was never to be made.

27 At this time the federal government did place trust funds in state securities, many of which, according to Ratchford, "were later defaulted or scaled down." *American State Debts* (Durham, N. C., 1941), pp. 84, 242–45.

28 Less $5,000,000.

29 *Messages and Papers of the Presidents*, III, 240.

30 At the same time Congress declared that only it, and not the Secretary of the Treasury, should have the right to call for repayment of the sums already deposited. This amounted to explicit recognition that they were a gift.

As a historical curiosity it is interesting to notice that forty-six years later, in 1883, Virginia attempted to secure the final installment. In 1884 a decision of the Supreme Court adverse to Virginia settled the debate. (See Bourne, *History of the Surplus Revenue of 1837*, pp. 42–43.)

INTERNAL IMPROVEMENTS AND "A DEFECT OF CONSTITUTIONAL AUTHORITY"

Before the full significance of this episode can be appreciated, it will be necessary to look briefly at the history of internal improvements during this same period. As has already been noticed, internal improvements had been favored by Jefferson and Gallatin. In 1802, when Ohio was admitted to the Union, provision was made for applying 5 per cent of the proceeds from the sale of public lands in the state for construction of roads connecting the eastern rivers with the Ohio; and this precedent was followed when other western states were created. The Cumberland Road was begun in 1806 and ultimately it stretched westward for 834 miles.[31]

But constitutional doubts loomed up early, and by none were they more meticulously stated than by President Madison. He favored internal improvements. "No objects," so he informed Congress, "within the circle of political economy so richly repay the expense bestowed upon them; . . . none do more honor to the governments whose wise and enlarged patriotism duly appreciates them."[32] The national government, however, was debarred from this field by "a defect of constitutional authority";[33] and he supported his opinion by examining, with careful subtlety, the argument that the general welfare clause authorized federal action. Acceptance of this argument would, he averred, leave no "adequate landmarks" separating the powers of the federal and state governments. It would "have the effect of excluding the judicial authority of the United States [the Supreme Court] from its participation in guarding the boundary between the legislative powers of the General and the State Governments, inasmuch as questions relating to the general welfare, being questions of policy and expediency, are unsusceptible of judicial cognizance and decision."[34]

[31] In this instance Congress was careful to pacify the states through which the road ran. State consent was required, and Pennsylvania made conditions which took the road off a direct route. Congress exercised no jurisdiction in the construction and upkeep of the road, and after construction was finished there was continuous debate over the right and duty of Congress to allocate money for maintenance. Finally the road was turned over completely to the states and they raised most of the necessary revenue for maintenance by tollgates.

[32] *Messages and Papers of the Presidents*, I, 567: Dec. 5, 1815.

[33] *Ibid.*, p. 268.

[34] *Ibid.*, p. 585. The statement was made (March 3, 1817) in a veto of a bill setting aside certain federal revenue for internal improvements.

For a time during the early 1820's the abundant federal revenue seemed to be softening the hearts of the constitutional purists. But this ended with the election of Jackson. Although he did not know just where the line should be drawn between improvements of a national and a local nature, he held that grants for improvements lying entirely within a state and subscription to the stock of "private associations" were surely unconstitutional. They were, in his opinion, "the entering wedge" of a system which "might soon become strong enough to rive the bands of the Union asunder." [35]

FEDERAL INTERVENTION REPULSED

While this debate was going on, the finances of many of the states had undergone a veritable revolution. After federal assumption of their debt in 1790, they had been left in a strong fiscal position with modest expenditures and taxes so light as to be insignificant. For nearly thirty years no important changes occurred. Then, beginning in the 1820's, many states ventured into economic activities on an extended scale, and this at a time when a laissez-faire philosophy was dominant and in a nation where the doctrine of rugged individualism was widely avowed. What explains this dichotomy of practice and theory? By 1820 a population of over two and one-half million had poured into the west, and streams of internal commerce had begun to take shape. Internal improvements would swell this commerce; they would bring prosperity to the states which participated. Why did not private enterprise furnish the improvements? Because the ventures were too risky and on too large a scale.[36] And since the federal government was debarred, state support by guarantee, or direct state enterprise, was inevitable.

A favorable tissue of events enabled the states to borrow with unprecedented ease. The prosperity of the nation after 1820 permitted some accumulation of domestic capital, and in addition foreign capital—especially British capital—was attracted by state securities. The federal government by retiring its debt with great celerity forced investors to look elsewhere for employment of their

[35] *Ibid.*, III, 120; II, 487, 509.

[36] According to Callander ("The Early Transportation and Banking Enterprises of the States in Relation to the Growth of Corporations," *Quarterly Journal of Economics*, 1902–03, p. 136), there had not been up to 1815 "an industrial undertaking in the country that called for as much as a million dollars capital."

funds, and it also provided a remarkable example of financial conservatism. No wonder British investors, unacquainted with the intricacies of federalism, turned eagerly to state issues! And the British investor who enquired about the use of the funds might be further reassured, because internal improvements were, in his experience, profitable ventures.[37] State debt, which did not total more than $13,000,000 in 1820, was $174,000,000 in 1837. With the crash and the prolonged depression which followed, it turned out that the improvements had saddled the states with a heavy burden of dead-weight debt. "Between 1841 and 1842 eight states and one territory defaulted on their interest payments."[38] The plain fact was that the states had stretched their functions beyond their fiscal resources. Their predicament was, in short, just opposite to that of the federal government.

The history of this period throws light upon the fiscal problems of federalism, since it gives a clear example of a maladjustment of governmental functions and resources. The federal government, because of constitutional restrictions and still more because of the political pattern, had a range of functions more limited than its fiscal resources; the states had undertaken duties which were more extensive than they could finance.

In this sorry situation a new and vehement plea went up for federal intervention. Coercion of the defaulting states was out of the question—although this was beyond the comprehension of many British investors. Federal assumption of state debts seemed more feasible. But how treat the states which were not in fiscal difficulty? Nobody ventured to suggest that *only* those in difficulty should be aided. And aside from details, federal assumption was not practical politics.[39] The Secretary of the Treasury, Mr. Bibb, expressed the pious hope in his report for 1844 that "the immutable principles of justice and moral obliga-

[37] A good many states, especially in the southwest, used their credit for banking purposes.

[38] R. C. McGrane, *The Economic Development of the American Nation* (Boston, 1942), p. 228. For a full account see, by the same author, *Foreign Bondholders and American State Debts* (New York, 1935).

[39] Senator Benton, in a series of resolutions, denounced assumption as "a gross and flagrant violation of the constitution," as "unjust and therefore inexpedient," as designed to bring about a complete "consolidation" of the government and the "crowning mischief" of foreign interference. U. S., 27th Congress, 1st session, Senate Documents 1839–40, No. 153; *Congressional Globe*, 1839–40, Appendix, pp. 86–92.

tion . . . and the virtuous precepts and bright example of the Federal government might not go unheeded" by the states.[40] His hopes and regrets, however, had doubtless been inspired merely by the adverse effect which repudiation had, especially in Europe, upon federal credit.

"The Minimum of Federal Government"

The bitter experience of these years had a tremendous influence upon state finance. In a spirit of reaction against the mistakes which had been made, new state constitutions were drawn up and in them severe restrictions were imposed upon legislative borrowing. The states as a whole withdrew from their old economic ventures and they resolutely refused to enter into new ones.

The federal finances were, of course, much less affected. For a time there was temporary embarrassment as deficits succeeded surpluses. A government which had no debt now had to borrow, and yet it found a market which was singularly skeptical. Investigation of federal expenditures disclosed also a number of gross scandals. The relatively few jobs being handled by federal officers were being handled badly. Federal money was being wasted, not through grandiose projects, but by ignorant spoilsmen each striving for a share of petty graft.

Gradually, with the return of prosperity, surpluses again became the rule, and, beginning in 1850, the federal government again faced the problem of excessive revenues despite a tariff which approached free trade. As in the 1830's, the restricted range of federal functions left no scope for expenditure. The principal use for the surplus was reduction of the federal debt, and since the flow of maturities was inadequate, the treasury had to rely on purchase in the market. This proved to be an expensive business. Thus on stock certificates retired in 1851–52, amounting to $2,523,200, the premiums were almost 13 per cent. In 1853 the Secretary of the Treasury offered premiums ranging

[40] Page 659. In 1842 an attempt to float a loan in Europe at 6 per cent had failed. President Tyler commented as follows: "The mortifying spectacle has been presented of the inability of this government to obtain a loan so small as not to amount to more than one-fourth of its ordinary annual income, at a time when the Governments of Europe, although involved in debt and with their subjects heavily burdened with taxation, readily obtained loans of any amount at a greatly reduced rate of interest." *Messages and Papers of the Presidents*, IV, 208: Dec. 6, 1842.

from 8½ per cent to 21 per cent to induce creditors to give up their stock.[41] By 1857 the total of the federal debt was down to $28,700,000.

As the sectional rift deepened, president after president solemnly repeated the warning in Washington's Farewell Address against geographical parties.[42] A corollary to this was "a spirit of strict deference to the sovereign rights and dignity of every State." [43] Two familiar instances of the outcome of this philosophy may be recalled. In 1854 Congress passed a bill providing that the proceeds from the sale of ten million acres of public lands should be divided as a capital fund among the states for the support of the indigent insane.[44] President Pierce interposed a veto. If Congress had the power to provide for the indigent insane, it would have "the same power to provide for the indigent who are not insane." The upshot would be "to transfer to the Federal Government the charge of all the poor in all the States," which would be "subversive of the whole theory upon which the Union of these states is founded." "If," he concluded, "the time shall ever arrive when, for an object appealing, however strongly, to our sympathies, the dignity of the States shall bow to the dictation of Congress by conforming their legislation thereto, when the power and majesty and honor of those who created shall become subordinate to the thing of their creation, I but feebly utter my apprehensions when I express my firm conviction that we shall see 'the beginning of the end.' " [45] President Buchanan, less rhetorically, expressed a similar fear in vetoing the Morrill bill granting aid to the states for establishment of colleges for the benefit of agriculture and mechanical arts. "Should the time arrive," he said, "when the State governments shall look to the

[41] *Annual Report*, 1853, Appendices D, E, F.

[42] Alexis de Tocqueville, writing in the 1830's, thought that the federal government had lost and would continue to lose ground. "Far from participating in [the current] dread of the consolidation of power in the hands of the Union, I think the Federal Government is visibly losing strength." Predicting that within a century the nation would have a population of over 100,000,000 scattered unequally over forty states, he declared that "the continuance of the Federal Government can only be a fortunate accident." *Democracy in Action*, translated by Henry Reeves (New York, 1900), I, 410, 403.

[43] *Messages and Papers of the Presidents*, V, 224 (President Pierce, Dec. 5, 1853).

[44] See Helen E. Marshall, *Dorothea Dix* (Chapel Hill, 1937), pp. 138–39, 148–51.

[45] *Messages and Papers of the Presidents*, V, 248–51: May 3, 1854.

Federal Treasury for the means of supporting themselves and maintaining their systems of education and internal policy, the character of both Governments will be greatly deteriorated." [46]

In ways like these a philosophy of federal impotence was elaborated. "The minimum of Federal Government," said President Pierce, "should afford the rule and measure of construction of our powers under the general clauses of the Constitution." [47] Such a fatal paralysis set in that no statesman of moderate position espoused anything but drift. As late as January 28, 1861, President Buchanan is to be found protesting his constitutional scruples against any interference with the war-making power of Congress. Exaggerated constitutionalism is certainly a feature of federalism, and certainly the belief is not without foundation that a nation so large and diverse as the United States can best be kept in cohesion by "the minimum of Federal Government." Yet in 1860, at the end of a long trial, the situation contradicted the doctrine, and after the Civil War a reunited nation was never to go back so completely to the old philosophy.

Economic Development and Fiscal Laissez-faire

The finances of the United States during the Civil War give no important background for this study. The war settled the old debate about national supremacy; it forced federal exploitation of new sources of revenue; and it cleared the way for new avenues of federal expenditure. But for a considerable period the new philosophy was not fully reflected in the public finances. The federal government at first was busy with post-war readjustment, and then with policies which made for the economic development of the nation. It, and the state governments also, aimed at providing fuller opportunities for private enterprise.

Most observers were astonished at the speed with which the purely financial difficulties confronting the federal government were resolved. Beginning in 1866 and stretching to 1893, the treasury had a long series of surpluses, broken only by a small deficit in 1874. In 1882 the Secretary of the Treasury was making the same complaint as had his predecessors in the 1820's and 1830's—that he had too great an annual revenue. Congress required his advice not to get revenue into, but to get it out of, the

[46] *Ibid.*, 544: Feb. 24, 1859.
[47] *Ibid.*, 224: December 1853.

treasury. During the war new sources of revenue—income tax, death duties, a wide range of excises—had been added. Because of inexperience and because the United States is a federalism, these had been slow in getting under way. Their productivity was not mobilized until the war was nearly over and then, with the decline of military expenditure, surpluses became too large. Repeal of income and death taxes was prompt; excises, except on a few luxury articles, were gradually dropped. Reduction of customs duties, however, was not feasible,[48] and they, together with luxury excises, provided more revenue than was needed. Retirement of the debt was, of course, an obvious step, and it was taken. But maturities were not adequate in amount and the treasury was forced to buy in the market at prices which gave large premiums to bondholders. An astonishing lack of imagination over ways to spend was manifested by Congress. Expenditure for pensions, river and harbor improvements, and public buildings did grow; the old expedient of distributing the federal surplus was discussed. The political philosophy of neither party, however, authorized any important expansion of federal functions.

The fact is that, at this time, monetary issues obscured all other, and when in 1892–93 the nation fell into depression, these complicated the job of the treasury. Not only had the crackpot legislation of the silverites frightened investors at home and abroad, it had also brought a stream of paper money to the treasury for redemption, and suspension of the specie payments was narrowly averted.

The most notable phenomenon to the student of federal finance was, however, the income tax of 1894. Behind it were radical sentiment, which favored taxing the rich, and the fear of the Democrats that lowering the tariff might injure the federal revenues. The act as passed had many defects, but when taken before the Supreme Court in 1895 it was not struck down because of them. By a most unfortunate decision the Court held that a tax on income was a "direct tax," which had, therefore, to be apportioned among the states according to population. The words of Justice Harlan, in dissent, were not too strong when he said that the decision "strikes at the foundations of national authority, in that it denies to the general government a power

[48] Purely revenue duties could, of course, be reduced. The McKinley tariff actually was called "an act to reduce the revenue."

which is, or may become, vital to the very existence and preservation of the Union in a national emergency." [49]

When in 1895–96 prosperity returned to the nation, the monetary heretics soon lost their audience. The Spanish-American war in 1898 was readily financed, and with the twentieth century the federal government began to engage in activities which were out of the old grooves. The most spectacular was the building of the Panama Canal, but others of less scope were indicative of a new attitude. Reclamation of dry lands was begun, a federal forest service was set up and extended, the Department of Agriculture offered many new services to farmers, Washington began to be made a city of magnificent buildings. Most of these, indeed, aimed at improving the economic productivity of the nation, and, in this sense, were comparable to the aid given earlier to railway building. In 1913, however, the Department of Labor was established, and this was a symptom of a new interest in social legislation. In this same year adoption of the sixteenth amendment, by removing the income tax from the category of "direct" taxes, made possible the utilization of an important source of revenue; and this also was a token of federal expansion.

The Decline and Rise of the States

If details are omitted and attention is concentrated merely upon broad outlines, the financial history of the American states for three decades after the Civil War appears remarkably static. In 1870 state debt (less sinking funds) per capita was $9.15; in 1900 it was $3.10. This may, perhaps, seem to indicate a satisfactory trend, but it did not. Partly because of constitutional limitations and partly because of the tradition of laissez-faire—the one reinforced the other—the states as a level of government had lost ground. One contemporary observer—H. C. Adams—insisted in 1887 that the state governments, by their passivity, had allowed corporate development to get out of hand. The corporations, he said, "arose upon the ruins of the States as centers of industrial administration, and it is because the States have failed to retain a proper control over them that they now menace the permanency of popular government." [50] Adams preferred ex-

[49] 158 U.S. 671.

[50] H. C. Adams, *Public Debts* (New York, 1887), p. 393. Adams believed that two steps were necessary to rejuvenate the states: (1) restoration of borrowing

pansion of state rather than federal functions; but he warned that, if the states failed to move, federal intervention was bound to come. Other observers held a similar view. Richard T. Ely even surmised that perhaps "the position of mayor of a great city will soon become a more enviable office than that of governor of an American commonwealth."[51] Certain it was that urbanization had forced upon the cities new duties with respect to health and sanitation, education, hospitals, protection to life and property.

The fears of these men did not materialize. Slowly the states recognized their concern with the new functions, usually by estab-

TABLE 1

STATE EXPENDITURES PER CAPITA[a]

	1903	1913	Increase
General government	.32	.42	.10
Education	.80	1.38	.58
Charities, hospitals, and corrections	.65	.90	.25
Highways	.06	.14	.08
Other	.29	.43	.14
	$2.12	$3.27	$1.15

[a] Not including expenditure for public-service enterprises, interest, and outlays.

lishing supervisory and regulatory bodies—a state board of health, for instance. Education, in particular, received state assistance by grants in aid; and state penal, reformatory, and charitable institutions grew in number and importance. And with the twentieth century, the growth of state social and regulatory expenditures accelerated, as shown in Table 1. State debt per capita grew from $3.03 in 1903 to $3.57 in 1913, and although this change was not great, it did represent a reversal of the previous trend. State revenue systems had become somewhat more diversified. The general property tax still was by far the dominant

power by removal of the self-imposed constitutional restrictions, and (2) repeal of the eleventh amendment. The eleventh amendment is itself a curious relic of federalism. In 1792 the states as sovereign bodies were shocked to find that they could be brought into court by a citizen of another state (*Chisholm* v. *Georgia*, 2 Dallas 419). The eleventh amendment was adopted to remedy this defect of sovereignty. After the repudiation of state debts following 1837 and after the Civil War, many people deplored the amendment and regarded it as a deterrent to creditors. More recently, however, this aspect of the amendment has been forgotten.

[51] R. T. Ely, *Taxation in American States and Cities* (New York, 1888), p. 263.

source, but the inheritance tax and business taxes had become important. Moreover, tax administration began to be centralized. State boards of equalization and state tax commissions had come into existence with power to supervise local assessment of property and actually to take over assessment of public service corporations.

The Recent Maladjustment of Governmental Functions and Resources

Before the outbreak of World War I, federal–state finances in the United States were in fair equilibrium. A close scrutiny could discern tendencies which, perhaps, threatened to bring an upset; but these lay in the future. Separation both of sources of revenue and of functions was nearly complete. The federal government in 1915 relied predominantly on indirect taxes—customs, excises on liquor, and tobacco. An income tax had, indeed, been started; but exemptions were high, rates were low, and as a result, it produced only 11 per cent of the total ordinary receipts in 1915. The field of revenue open to the states still seemed large. With respect to expenditures, the states were beginning to realize that the governmental duties which fell upon them were growing in importance, and state grants to the localities were expanding. But federal grants to the states were insignificant, amounting in 1915 to approximately $10,400,000.

The war dislocated this governmental pattern. During its course the federal government greatly expanded its tax system, and after its close less reversion took place than after the Civil War. As the federal fiscal position gradually eased during the 1920's, some new duties were assumed. The states, however, were confronted with revolutionary demands for expenditures, of which the most important was highways. In 1919 the ordinary highway expenditure of the states was $.59 per capita; in 1930 it was $2.06. In this same period, state debt per capita had nearly doubled,[52] and over 60 per cent of this debt was for highways. Only the fact that this voracious type of expenditure carried with it a method of finance—gasoline tax and motor vehicle taxes—kept the states from a critical fiscal position. The contrast between federal and state financial positions was strik-

[52] Net state debt per capita: 1919—$7.70; 1930—$15.03.

ing. Federal debt was shrinking, while state debt was going up; federal taxes were being reduced, state taxes were being increased. Some people attributed these results to the presence or absence of fiscal prudence, but the causes lay deeper. The states, with a few exceptions, were not being extravagant. They were responding to sober and well-founded public demands.

It took the great depression after 1929 to show the many and important governmental duties which had been neglected in the United States. And this knowledge did not come easily. For two years Congress and the president hoped that prosperity was just around the corner and they held tenaciously to the opinion that the problem of unemployment was a state and local responsibility. The kernel of truth in this opinion allowed able men to forget that the states and localities could not possibly handle *finance*. They had too many duties and too few revenues. The growth in duties was the consequence of a shift in social philosophy which had been stimulated by the depression. Social welfare functions, including the relief of unemployment, had seemed unimportant in an expanding and prosperous economy. But when economic collapse brought unemployment and destitution on a scale beyond all precedent in American experience, a powerful public sentiment insisted that governmental fumbling should cease. Since relief was necessary, and since only the federal government had the fiscal strength to provide relief, debate over responsibility seemed irrelevant. This public reaction brought into office at Washington a reform administration which was prepared to act. Social welfare and relief measures were passed; the traditional division of governmental responsibilities was cut across and sometimes ignored. The general direction of this new trend may be approved, and yet one may feel certain that in detail there has been confusion and error. For example, a principal instrument of the shift in fiscal responsibilities has been the conditional grant in aid.[53] One may believe that this sort of grant is a power-

[53] The amount of federal aid grew as follows:

	Total	Public assistance	Highways	Education	Agriculture	Other
	(in millions of dollars)					
1925	113.6	—	92.1	11.8	7.4	2.3
1932	217.1	—	118.5	13.2	12.2	2.6
1941	744.2	331.2	168.3	88.0	24.8	131.9

Source: U.S. Department of Commerce, State and Local Government Special Study No. 19, *Federal and State Aid: 1941*.

ful and a beneficial device, and yet be critical of specific schemes. Moreover, the evidence is unambiguous that no logical system of grants has been built up. In short, improvisation has been the rule. Whatever should be the redistribution of functions and sources of revenue in the American federalism, that redistribution has not yet been achieved.

This brief historical prologue may serve to bring out the difficulties faced by a federalism in achieving a coherent fiscal system. Only after bitter experience in the critical period did the federal government secure strong fiscal powers, and only after a sharp struggle did it venture to exercise them in a manner which secured the federal credit. The perplexities of federalism were constantly in men's minds until it seemed to so forthright a centralizer as Fisher Ames that any governmental move produced the cry of unconstitutionality, "not excepting a motion for adjournment." And as the tide of settlement poured over the mountains, the forces of sectionalism gained new strength. Every president was conscious of these forces, and Pierce merely epitomized the common thought when he declared for "a minimum of Federal government" and "a spirit of strict deference to the sovereign rights and dignity of every state."

This it was which produced the curious and unique episodes which enlivened the financial history of the thirty years prior to the Civil War. How could the federal revenue be reduced? Since there was a limit below which the tariff could not be lowered, perhaps the proceeds from the sale of the public lands could be distributed to the states; or perhaps the federal surplus could be deposited with them. This surplus could not be used to reduce the debt because in 1836 no federal debt existed; and it could not be used to enlarge the scope of federal expenditure because that would be incompatible with "a minimum of Federal Government." Yet at this very time when the federal government was inhibited against expansion of its functions, the states were embarking upon tasks which overtaxed their limited fiscal resources.

The period before the Civil War illustrates a typical difficulty of a federalism. This is the lack of balance in the distribution of governmental functions and revenues. The tendency is for the states as a whole to have a plethora of duties in relation to

the revenues at their effective disposal. The case of the federal government tends to be the other way round. This situation is, however, obscured in two ways. Some of the states are always able to handle their governmental duties even when their weaker brethren cannot. And sometimes periods of crisis arise which strain the fiscal strength of the federal government and raise doubts in some minds of its power to expand its peacetime functions. These doubts have been falsified. The exercise of new tax powers in the crisis, or the more vigorous exercise of old tax powers, brings to light a latent strength and leads to a permanent expansion of federal sources of revenue. The net result is, therefore, a narrowing of the fiscal power of the states and a growth of federal functions.

This pattern was very obvious in the years after World War I. The states, expanding their expenditures in response to deep-seated public demands, had difficulty in securing a parallel expansion of their revenue systems. With the great depression the maldistribution of governmental functions and revenues became manifest. Only the federal government had the fiscal power and the national outlook requisite to handle the welfare and relief measures which the times demanded.

What will be the pattern after World War II? Some people, impressed by the vast fiscal problems facing the federal government and by the current buoyancy of the state finances, are inclined to doubt that the sphere of federal action will be expanded. The opinion is ventured here that this doubt is unwarranted. Exercise of its wartime powers is likely to augment permanently the position of the federal government as compared with the states. If the public demand for governmental services continues to grow, the state governments will soon appear to have more duties than they can handle effectively, and federal intervention will be indicated.

CHAPTER II

FISCAL PROBLEMS OF FEDERALISM

Our dual form of government has its perplexities, State and Nation having different spheres of jurisdiction, . . . but it must be kept in mind that we are one people; and the powers reserved to the States and those conferred on the Nation are adapted to be exercised, whether independently or concurrently, to promote the general welfare, material and moral.

JUSTICE MCKENNA.[1]

Constitutions are intended to preserve practical and substantial rights, not to maintain theories.

JUSTICE HOLMES.[2]

UNITARY *v.* FEDERAL COUNTRIES

IN THE PAGES which follow, explicitly or implicitly, a contrast will be drawn between the fiscal problems of a federal and of a unitary country. The lines of demarcation are, however, never sharp, because no country is strictly unitary and none is completely federal. Yet the contrast is not a make-believe, and at the outset a brief sketch of its essentials must be attempted.

In a unitary country there is, broadly speaking, no question about the constitutional power of the national government. It can do what seems expedient, or wise, or just, without constitutional objection from the inferior governments. But a federal country has an extra layer of governments—the states—between the national government and the localities; and these governments have functions and revenues secured to them by constitutional provision. This intermediate layer of governments is in no sense artificial. Without it no federal nation could ever have been formed, and if formed, it could never have lasted. There was in 1787 no alternative to federalism for the United States, because only federalism would work.

A federal constitution represents the outcome of a tug and pull between three broad groups. On the one hand is a group which desires a strong national government, dominating the states; on

[1] *Hoke* v. *United States*, 227 U.S. 308 at 322.
[2] *Davis* v. *Mills*, 194 U.S. 451.

the other is a group which desires to endow the national government with palsy rather than with power. In between stand the trimmers who are not prepared to let ideas of what is best defeat ideas of what is good; and they, drawing support from both extremes, frame a plan which has some chance of success. In this plan there is a distribution of powers with the center of gravity not too far toward the national government, else we have a unitary form, or too far toward the states, else we have a confederation.

Unfortunately, as times change, the original division of functions between the federal government and the states may get out of date. It may seem to belong to the horse and buggy period. Our ideas as to what are appropriate duties for government may shift; a crisis may expand the federal power and federal sources of revenue; economic or technological factors may bring within the national sphere issues which were once only of local importance. In short, a maladjustment of functions and sources of revenue may arise because of a change in political and social philosophy, or economic and technological changes, or the impact of war and depression. Some critics declare that American federalism is obsolete, and demand a great enlargement of the powers of the national government.[3] They are impatient at the obstacles which stand in the way of governmental action and experiment on a grand scale. Some of the obstacles exist because the framers of the Constitution exercised great care to see that hasty changes could not be made. Some exist because in a federalism a Supreme Court has been set up as an oracle to interpret the generalities of constitutional statement and as a referee to keep the federal government and the states from trespass upon each others' spheres.

The advocates of centralization cannot be dismissed by appeals to the shibboleths of states' rights. In the past decade or more, most thoughtful citizens of the United States have been troubled by certain incongruities—even inefficiencies—of federalism, and not a few have lusted after the apparent simplicity of the unitary form of government. Are needy individuals in a federal country to be deprived of desirable governmental services because of niceties of constitutional law? Certainly the critics of federalism

[3] Professor Harold J. Laski has said: "American federalism, in its traditional form, cannot keep pace with the tempo of the life giant capitalism has evolved." "The Obsolescence of Federalism," *New Republic,* May 3, 1933, p. 369.

have a case. It would be neither wise nor tolerable to have a constitution which offered a permanent barrier to the best solution of our social problems. A constitution should be a road and not a gate; a form of government should be amenable to the demands of a changing civilization.

But it should not be forgotten, as it is likely to be by those in whom the humanitarian spirit is strong, that, wholly apart from constitutional reasons, national agencies ought not to be loaded with many vital tasks. There are many social services affecting the diverse daily life of the people about which uniform regulation and administration from a central source would be mischievous as well as impracticable. Old-age assistance is one example, education is another. Uniform rules about these would be irresponsive to the variety of state and regional needs. The partisan of federalism will say that when the people of a nation are not homogeneous in social outlook, traditions, and economic interests, centralization in government must not go beyond flexible limits. The national interest in such a country simply and plainly is circumscribed in comparison with the national interest in a unitary nation. The unitary and the federal form of government cannot, like a coat, be assumed and doffed at will by any country. For some countries federalism is appropriate because only federalism is practicable.

To those philosophers who favor growth of the public sphere and also experimentation in government on a grand scale, this will seem a dreary conclusion. If the national government is to be cribbed and confined in its policies, then its achievements (and its failures) cannot be spectacular. This disappointment may, perhaps, be somewhat assuaged by one counter consideration. The states do provide limited laboratories in which democracy can train itself in the art of government by carrying on political and economic experiments. The late Justice Holmes repeatedly emphasized this point. In a famous dissenting opinion [4] he said: "There is nothing that I more deprecate than the use of the Fourteenth Amendment beyond the absolute compulsion of its words to prevent the making of social experiments that an important part of the community desires, in the insulated chambers afforded by the several states, even though the experiments may seem fu-

[4] *Truax* v. *Corrigan*, 257 U.S. 312 at 344.

tile or even noxious to me and to those whose judgment I most respect." An Australian Royal Commission on the Constitution made the same point when it said: "Where there are adequate powers of self-government, there is scope for public spirit, local patriotism and local knowledge, which would be lost if all legislative and administrative functions in Australia were absorbed in the central government. Again, the existence of self-governing states does, we believe, provide the best means of supervising development and the best safeguard against a disastrous experiment." [5]

These, then, are the considerations which weigh against overhasty steps toward centralization. They must not be interpreted to mean that no action to meet vital governmental duties should be taken; they do suggest that this action should conform to federalism. Someone has said: "Historical continuity with the past is not a duty, it is only a necessity."

Functional Expenditures in the United States and England and Wales

In order to secure some notion of the difference between the division of functions in a federal and a unitary country, a rough comparison is given below of the relative expenditures for specified purposes in the United States and England and Wales. Absolute differences in levels of expenditure are completely neglected,[6] and a warning must be given that the figures for England and Wales are only approximations which will not stand minute scrutiny.

Table 2, none the less, brings out important facts, the most obvious of which is the marked difference in the share of total expenditure for justice and police, and for education, borne by the federal government in the United States and the national government in England and Wales. (If pre-depression figures for expenditure on relief, welfare, and social security were available, the same difference would be shown.) In England and Wales the national government has a much greater financial responsibility for these functions. In the United States a considerable part of

[5] *Royal Commission on the Constitution* (Canberra, 1929), p. 241.

[6] It is not, for example, of much significance for the purpose in hand that, on a per capita basis, expenditure for highways and streets is much greater, and expenditure on defense much less, in the United States than in England and Wales.

TABLE 2

RELATIVE EXPENDITURE OF GOVERNMENTS IN THE UNITED STATES (1938) AND IN ENGLAND AND WALES (1935–36) FROM THEIR OWN SOURCES[a]

	Federal/ National %	State %	Local %	Total %
Defense				
United States	99	1	..	100
England and Wales	100	..	..	100
Justice and Police				
United States	5	19	76	100
England and Wales	39	..	61	100
Education				
United States	7	34	59	100
England and Wales	48	..	52	100
Relief, Welfare, and Social Security				
United States	70	20	10	100
England and Wales	87	..	13	100
Health and Hospitals				
United States	7	47	46	100
England and Wales	3	..	97	100
Highways and Streets				
United States	16	54	30	100
England and Wales	22	..	78	100

[a] The figures for the United States are from the Bulletin of the Treasury Department, August 1939, p. 4. The figures for England and Wales have been pieced together by rough and ready methods from the Statistical Abstracts for the United Kingdom, and from U. K. Hicks, *The Finance of British Government* (London, 1938); they are approximate only, but in relative form they cannot be much in error. A further warning is that the list of functions outlined above does not embrace all functions. Reference to the Treasury Bulletin will show that, for the United States, expenditure on "agriculture and natural resources," "net additions to social security reserves," "interest," and "all other" are left out.

the fiscal burden for education, and justice and police, has, however, been shifted from the local governments to the states. The states in these tasks stand between the localities and the federal government. The middle position of the states is shown also in a different manner with respect to other functions. Health and hospitals, and highways and streets, are relatively more of a local function in England and Wales than in the United States. In the United States the state governments carry the largest share of these expenditures. A word should be said also concerning the remaining function—defense—listed in Table 2. This duty falls more naturally and completely than any other upon the senior government, but in the United States it has not been completely centralized. The states started in 1789 with considerable power,

and although down the years this power has been whittled away, a few vestigial signs of federalism remain.

The Administrative Division of Functions

Whereas in Table 2 expenditures are assigned to the level of government providing the money, in Table 3 they are assigned to the level of government which actually handles the money. To put this in another way, in Table 2 intergovernmental transfers are included as part of the expenditure of the level of government which raises the money; in Table 3 they are included as part of the expenditure of the level of government which disburses the money. In Table 3 many of the striking differences between federal and national expenditure disappear. The relative share of expenditure on education, for example, handled by the national government in England and Wales is not very significantly different from that in the United States. Possession of unquestioned

TABLE 3

Relative Expenditure of Governments in the United States (1938) and in England and Wales (1935–36) for Their Own Functions

	Federal/ National %	State %	Local %	Total %
Defense				
United States	99	1	..	100
England and Wales	100	..	..	100
Justice and Police				
United States	5	19	76	100
England and Wales	..	..	100	100
Education				
United States	1	10	89	100
England and Wales	5	..	95	100
Relief, Welfare, and Social Security				
United States	62	20	18	100
England and Wales	70	..	30	100
Health and Hospitals				
United States	4	49	47	100
England and Wales	..	..	100	100
Highways and Streets				
United States	1	50	49	100
England and Wales	2	..	98	100

constitutional right to handle certain functions has not, therefore, meant their actual assumption. For administrative and other reasons, the national government in England and Wales has seen fit to leave the functions of justice and police, and education, mostly in the hands of the localities; but it has supplemented local revenues by giving them grants in aid of specific functions. These conditional grants have strings attached which compel the local governments to meet certain standards and which, therefore, modify local control. In the United States also, as is well known, the conditional grant has been widely used both by the federal government in subsidizing the states and localities, and by the states in subsidizing the localities.[7] Table 4 shows the relative

TABLE 4

Grants as a Percentage of Total Functional Expenditure

	England or Wales	United States		
		Total	Federal	State
	%	%	%	%
Defense	..	..	..	..
Justice and Police	43	..	..	..
Education	43	33	7	26
Relief, Welfare, and Social Security	7	18	8	10
Health and Hospitals	3	4	3	1
Highways and Streets	21	32	15	17

functional use of grants in the United States and in England and Wales.

The precise similarity of grants in the two countries should not, however, be lightly assumed. The national government in England and Wales has no "defect" of constitutional authority; in a constitutional sense, it cannot be accused of "invading" local functions by giving subsidies and by imposing conditions. But in the United States, as in any federation, constitutional lines are drawn demarcating the spheres belonging to the federal government and to the states. The lines are never distinct and their boundaries shift in accordance with the temper of the times and judicial interpretation. Yet their reality is undeniable. And this block to federal action does not rest merely upon constitutional provision.

[7] In slight measure the local governments have made transfers to the states. See *Bulletin of the Treasury,* August 1939, p. 4.

Behind it lies the heterogeneity of a federal country which makes difficult the prescription of a national policy and which hinders acceptance of federal conditions by the people of the different states. The fact, then, is that the strings attached to conditional grants in the United States have usually been less numerous and more slack than those in Great Britain.

A Dilemma of Conditional Grants in a Federal Country

This situation, however, conceals a paradox; and, in order to secure a fuller picture of the differences between grants in a federal and in a unitary country, it may be helpful to work out the theory by use of simplified models. Let us imagine a nation which is severely or ideally unitary and which is therefore homogeneous, not merely in governmental forms, but in the essentials of social and economic life. There should be geographical homogeneity throughout the nation so that marked divergences among *areas* in wealth and economic pursuits do not occur. In each *area* there will be rich and poor, farmers and industrialists, but in similar proportions. In such a nation any proposed governmental policy may raise differences of opinion along class lines, or along lines of economic interest, or some other. But the lines of conflict will not be geographic; rather they will be spread over the face of the nation.

It will not be necessary to suppose that all governmental functions are handled by the national government. Local governments will have tasks to perform, not because of any defect in the national power, but for the sake of administrative efficiency. These local governments will, however, be assumed to be homogeneous with respect to the level and the distribution of wealth of their inhabitants. How are the local governments to get their revenue? Some sources will naturally be in their hands for administrative reasons and because certain services are rendered on a *quid pro quo* basis, but these will not be adequate to support local functions. Local governments have an administrative ability for performance of functions which is greatly in excess of their administrative ability for the collection of revenues. The case of the national government is the other way round: it has an ability to make efficient collection of taxes which is greater than its ability to handle expenditure. In such a case, subsidies will be pro-

vided from the national treasury to the local governments, and since the localities are homogeneous with respect to resources, it would be easy to find an objective basis, such as population, upon which to base distribution.[8] Determination of the amount of the subsidies would depend upon the same sort of collective judgment applied to other expenditures, since there would be no point in drawing a distinction between the national and the local interest in functions.

Let us consider next what conditions should be attached to the grants. If functions are allocated according to administrative ability—if the localities are given only those duties which they can best handle—then detailed conditions will be out of place. Once the relative level at which the nation wishes various local functions to be performed is settled, the performance can be left to the localities. It may, however, be objected that conditions would be necessary to prevent the localities from diverting grants away from any given purpose into other channels. Here again the assumption of homogeneity serves to restrict narrowly any danger that this may happen. The centrifugal force which, in actual fact, causes localities to diverge from a common pattern of governmental activity is the heterogeneity of the nation, and where that is not present a minimum of national supervision will serve to hold localities to common standards. Moreover, too much national supervision will lead to red tape and to bureaucratic frictions.

The most general ground given for attaching conditions to grants is embodied in the doctrine of financial responsibility, which means that a government should itself raise the funds which it spends. The argument is that citizens will put a check upon wasteful expenditures when they themselves supply the revenues. Any sort of subsidy might seem to infringe this doctrine, but the conditional grant can be fitted into it because the superior government attaches strings to its grants and because a part of the expenditure is provided from local sources. By using strings, the superior government, which is responsible for raising the revenue, imposes controls on the inferior governments as a substitute for the controls supposed to be exercised directly by the taxpayers; by requiring provision of a considerable proportion of local

[8] This sort of subsidy would be like a shared tax of which a predetermined amount was assigned to the localities.

money, the superior government ensures, it is presumed, that all the money will be safeguarded.

Consider this doctrine in relation to our ideally unitary country. The important fact to appreciate is that, in such a case, the process of central collection and local spending will not lead to inter-area transfers. There may, of course, be transfers from rich to poor persons within an area and within the nation, but the assumption of geographical homogeneity in the nation means that any uniform scheme of taxation levied by the national government and used for local grants both takes from and gives to localities uniform amounts. The local officers in each locality, who have the task of spending the grants, will be spending money raised from the citizens of each locality. Even if the national government imposed no supervision over grants, in this simplified case, responsibility and control would not be severed.

We come, accordingly, to the conclusion that, in an ideally unitary country, it would be unnecessary and even undesirable to attach detailed and severe conditions to local grants. Why, it may well be asked, have unitary countries not followed this practice? Part of the answer is that the logical pattern of devolution has been cut across by the historical pattern of centralization. Nevertheless, we do find recently in Great Britain a swing away from the earlier scheme of conditional grants toward "block" grants, which leave localities considerable freedom and eliminate detailed national supervision. Probably this is the direction of future trends. Another part of the answer is that the premise of homogeneity set forth above is never fulfilled in any actual unitary country. Localities differ in wealth, population, area, etc., and as a result national grants involve a geographical transfer of resources which is especially significant when an equalizing formula is employed. When poor areas are given grants to spend derived from taxation of citizens elsewhere, the doctrine of financial responsibility is infringed unless national supervision is exercised.

What bearing has this theoretical exposition on the use of grants in a federalism? Regional heterogeneity is of the essence of federalism, and the reasoning given above would seem to indicate that federal grants should be conditioned and closely policed. In practical fact, however, this would be an impairment of state sovereignty. Moreover, any detailed and uniform set of conditions would be unsuited to the diversity of regional and state

needs. In a federalism, variation in standards of many governmental functions is common, and therefore the federal government is likely to get into difficulties if it attempts to prescribe common standards in grant programs.

The outcome seems to be this: In a unitary country, uniform local standards for governmental functions are natural; inter-area transfers of resources are at a minimum; and therefore grants need not be tightly conditioned. In a federal country, diverse standards are prevalent; inter-area transfers of resources are important; and therefore grants should be tightly conditioned. But to surround federal grants with numerous conditions is to assume a homogeneity in state governmental needs which does not exist; to prescribe uniformity where there are deepseated reasons for diversity is an error. Here, then, is a dilemma of federalism.

Conflicting Taxation

The maladjustment in the distribution of governmental functions and revenues which is recurrent in a federalism has another facet. Because the states tend to have a disproportionate responsibility for the performance of functions, they tend to utilize sources of revenue which, in modern society, they lack the administrative capacity to handle. And sometimes, even when possessed of adequate administrative capacity, they are tempted to reach outside their boundaries after revenue which, by national standards of equity, does not belong to them. The result is multiple taxation, excessive costs of compliance and collection, increased business costs, and a reduced national income. Yet this condition cannot easily be corrected. The states certainly cannot relinquish sources of revenue without a *quid pro quo,* and in any case they fear a loss of constitutional power. How should a balance be struck? Is the solution to be found in adjustment of functions, either directly or by grants in aid, or in an adjustment of sources of revenue, or both?

An attempt will be made in subsequent chapters to trace and appraise the manner in which governmental functions and revenues have been divided between the federal government and the states. The fiscal mechanisms—some of them old but most of them new—by which a modicum of flexibility may be given to the

rigidities of federalism will receive attention. The mechanisms appropriate to each particular problem will be indicated, and then in a concluding chapter an effort will be made to draw the strings together. Throughout, however, the essential features of federalism are assumed to be retained.[9]

[9] A few of the advocates of centralization have declared that the states are an anachronism and that state boundaries should be wiped out, or at least redrawn. An academic person should not, perhaps, condemn this sort of proposal by saying that it is academic. But it brings to mind an act used often by the old comedians Weber and Fields. Weber knew that a dog wouldn't bite you if you looked him straight in the eye, and Fields knew that Weber knew. The real question was whether the dog knew. So the states may be anachronisms, but they do not know it.

CHAPTER III

DEFENSE

> The American militia, in the course of the late war, have by their valor on numerous occasions, erected eternal monuments to their fame; but the bravest of them feel and know that the liberty of their country could not have been established by their efforts alone, however great and valuable they were. War, like most other things, is a science to be acquired and perfected by diligence, by perseverance, by time, and by practice.[1]

THE FIRST DUTY of a national government, said Adam Smith in 1776, is "that of protecting the society from the violence of invasion of other independent societies. . . ." But Smith did not reckon with federalism, and in the new nation which was soon to be created across the Atlantic the growth of federal responsibility was slow. For decades the states participated in the vital task of defense, and even at the present time some vestigial remnants of dualism remain.

EARLY WEAKNESS OF THE FEDERAL POWER

The Articles of Confederation naturally give clear instances of the importance of state as compared with federal power. By their provisions, Congress could not declare war except with the assent of nine of the thirteen states; and it fell to the states, upon the request of Congress, to "appoint the regimental officers, raise the men and clothe, arm and equip them in a soldier-like manner, at the expense of the United States. . . ."[2] Beyond question this dualism hindered the efficient conduct of the Revolutionary War. The militia, called out by state authority to meet emergencies and enlisted for short terms of service, were a most unreliable military force. It is easy to parade specific instances of defects, but only two need to be given here. One reason for the disastrous assault upon the city of Quebec on December 31, 1775, was the approaching expiration of the term of service of a large portion of

[1] *Federalist*, No. 25, p. 150.
[2] Article 9.

the American army. And when in 1781 General Greene was besieging Fort Ninety-six in South Carolina, the Virginia militia, ordered to join him, was detained at home by Governor Jefferson.[3] Washington repeatedly and forcibly asked for a stronger standing army, enlisted for the duration of the war,[4] but to this there was a deep-rooted opposition which would not down even in the face of dire emergency, and there was besides the constitutional and political weakness of the federal authority.

While Washington was highly critical of the militia system as it had operated during the Revolutionary War, he was aware of and in accord with the common opinion that in time of peace a large standing army was undesirable. The wise policy was, he believed, to reform the militia so as to bring about uniformity in training, discipline, and equipment.[5] This was, however, not easy to accomplish. The new Constitution did increase the military powers of the federal government, although dualism persisted. Congress could "raise and support armies"; [6] it could "provide for calling forth the militia to execute the laws of the Union, suppress insurrections and repel invasions"; [7] and it could "pro-

[3] See Emory Upton, *The Military Policy of the United States* (War Department Document No. 290, Washington, 1917), pp. 59–60. General Greene wrote to the Governor: "I conceive it to be the prerogative of a governor to order the force belonging to a State as he may think necessary for the protection of its inhabitants. But those that are ordered out upon the Continental establishment are only subject to the orders of their officers. Without this just and necessary distribution there would be endless confusion and ruinous disappointments."

[4] In a letter to the President of the Congress, dated August 20, 1780, he declared: "Had we formed a permanent army at the beginning, which, by the continuance of the same men in service, had been capable of discipline, we should never have had to retreat with a handful of men across the Delaware in 1776, trembling for the fate of America, which nothing but the infatuation of the enemy could have saved; . . . we should not have been for the greater part of the war inferior to the enemy, indebted for our safety to their inactivity, enduring frequently the mortification of seeing inviting opportunities to ruin them pass unimproved. . . ." *Ibid.*, p. 162.

[5] The attitude of Washington toward the militia has been sharply debated. General Upton, in a work which was influential in shaping army opinion for many years, made him a severe critic, while Colonel John McA. Palmer in more recent writings (see *Washington, Lincoln and Wilson: Three War Statesmen,* New York, 1930) has insisted that this is a misinterpretation. No review of the historical evidence can be attempted here, but it appears that the debate is a paper one.. Washington was sharply critical of the militia system as it operated under his command, but he was hopeful of reform and he knew the strength of the feeling against a standing army. See also Frederick P. Todd, "Our National Guard: An Introduction to Its History," *Journal of the American Military Institute,* vol. V, no. 2, no. 3.

[6] Article I, Section VIII, Clause 12.

[7] Clause 15.

vide for organizing, arming and disciplining the militia, and for governing such part of them as may be employed in the service of the United States, reserving to the States respectively the appointment of the officers, and the authority of training the militia according to the discipline prescribed by Congress." [8] Under the army clause the constitutional power of Congress was unrestrained, but since in fact public opinion was against a standing army, the militia had to be the backbone of national defense and the Congressional powers over it were sharply limited. Possibly if Congress had been willing to assert its authority and to prescribe a discipline for the militia, the limitations might have been surmounted; but in the militia act of 1792 and in succeeding legislation for many decades, Congress did not prescribe. The control of the states over the militia became paramount and when in emergencies federal authority was asserted, there was a sorry display of inefficiency and confusion. In 1812 the governors of Massachusetts and Connecticut refused to furnish the quotas of militia asked by Congress on the ground that it was their duty, and not that of the president, to determine the exigencies which justified use of the militia; [9] and some of the Ohio militia, serving under General Hull at Detroit, refused to cross into Canada because they had no obligation to serve outside the United States.

The Civil War

Despite these signal demonstrations of weakness, and others which occurred during the Indian and Mexican wars, no important corrective legislation was passed. States'-rights sentiment grew in strength with every decade, and Congress shied away from any step which might raise state objections. The Civil War found Congress bound by a tradition of inertia and enfeebled by the disorganization of the crisis. Inevitably it turned to the states and placed in their hands the task of raising, organizing, and equipping troops. "The militia system of state control was grafted onto what was supposed to be a national army. . . . States rights had so strong a hold upon the minds of the major political parties, that they could conceive of no other way to create a larger army, than by turning the work over to the agency

[8] Clause 16.
[9] Upton, *Military Policy*, pp. 96–97.

of the states."[10] This system was lamentably inefficient, and gradually the federal government asserted a larger control. When in 1862 the attempt to secure enforcement of the draft by state officers failed, the enrollment act of 1863 was passed, by which the draft was conducted solely by federal officers. This was "a reaction against unrestricted state control of the army."[11] Yet it must be remembered that this federal conscription was in part intended as a club to encourage recruiting and that even after its passage a majority of the soldiers were raised by state and local effort. Moreover, this assertion of federal authority met with resistance so great that nothing short of the serious military situation would have won the assent of Congress.[12]

Grants in Aid and a Start at Reform

It might perhaps have been expected that the tragic ineptitudes of military organization revealed during the Civil War would have inspired reform. But nothing of the sort happened. The country went back to maintenance of a small standing army, and to reliance upon a militia which was completely in state hands. Not until 1886 was a modest effort made to establish some federal control, and thirty years more were to elapse before this control became effective. During this long stretch of years the principal instrument used to tighten the federal grip was the grant in aid.

Grants to the states for militia purposes have a long history. Beginning in 1808, Congress appropriated annually the sum of $200,000 to be used to assist the states in arming and equipping their militia,[13] but there was no attempt to impose conditions or

[10] F. A. Shannon, *The Organization and Administration of the Union Army, 1861–65* (Cleveland, 1928), I, 46–48. The South, however, driven by a more desperate need and a more cohesive sentiment, dropped the states'-rights theory in its conduct of the war. But as the years passed and as victory became more hopeless, a divisive spirit cropped up, the most famous instance being the refusal of Governor Joseph E. Brown of Georgia to recognize conscription and in 1864 to allow Georgia troops to be taken out of the state.

[11] Shannon, *op. cit.*, I, 307.

[12] Some figures of state expenditures for war purposes are presented by B. U. Ratchford, *American State Debts* (Durham, N. C., 1941), chapter vi. The federal government later reimbursed the states for part of this expenditure—reimbursements up to 1930 amounted to $55,481,000—but some states still have unsettled claims.

[13] See *Annals of Congress of the United States,* 10th Congress, 1st session, 1808, p. 2195. The bill originally proposed an annual appropriation of $1,000,000, but this was steadily whittled down by successive votes to $200,000.

to exercise supervision. Thereafter intermittent and halfhearted attempts were made at reform. Andrew Jackson in 1832 declared: "It is obvious that our militia system is imperfect. Much time is lost, much unnecessary expense incurred, and much public property wasted under the present arrangement. Little useful knowledge is gained by the musters and drills now established and the whole subject evidently requires a thorough examination." [14] Other presidents made similar criticisms, but not until 1886 was anything done. Then the annual grant was raised to $400,000, and the modest requirement was set up that no state should share in the grant unless it had at least one hundred militiamen for each senator and representative. There was, however, no attempt to enforce this condition, partly because of fear of the accusation of meddling and partly because an annual grant of $400,000 was equal only to one-seventh of annual state expenditure on the organized militia.[15] So insignificant a federal contribution, as President Cleveland pointed out in 1896, gave small excuse for imposition of federal conditions.

The Spanish-American War demonstrated once again that the states had organized their militia with every degree of neglect,[16] and thereafter the drive for reform took a more vigorous turn. President Roosevelt and his Secretary of War, Elihu Root, pressed for changes, and something was done.[17] In 1901 the annual federal appropriation for arming and equipping the militia—by now it was being called the National Guard—was raised to $1,000,000, in 1906 to $2,000,000, and in 1908 to $4,000,000. By the Dick act of 1903 and subsequent amendments, the federal government undertook to furnish standard arms and equipment to the Guard in exchange for the old, and to pay the expenses of the Guard when it took part in military exercises with the

[14] U.S., 57th Congress, 1st session, House Report No. 1094.

[15] A relatively few states, such as Massachusetts, New York, Pennsylvania, made most of the expenditure. In many of the small states, the federal appropriation was in excess of that of the states. See U.S., 52nd Congress, 1st session, House Report No. 754, p. 26, for the details for 1891.

[16] F. L. Huidekoper, *The Military Unpreparedness of the United States* (New York, 1915), pp. 163–66.

[17] President Roosevelt in 1901 said: "Our militia law is obsolete and worthless. The organization and armament of the National Guard of the several states . . . should be made identical with those provided for the regular forces. The obligations and duties of the guard in time of war should be carefully defined. . . ." U.S., 57th Congress, 1st session, House Report No. 1094, p. 10.

regular army. The organization and training of the Guard were to be brought into conformity with the regular army, and federal inspection of state performance was supposed to precede payment of the grant. In the annual report of the chief of the Division of Militia Affairs for 1908 the hope was expressed that under the new scheme the term "militia" would no longer be synonymous with "military inefficiency" and that in the future "military questions and military efficiency" would become predominant and "club and social features subordinate." [18] Certainly some improvement was won, but it proved extremely difficult to enforce federal supervision and constant friction developed between the Guard and the War Department.

The Mexican troubles and the outbreak of the first World War brought all of the issues about national defense before the public. How much should the regular army be strengthened? How could the personnel and the efficiency of the Guard be increased? Was it wise to rely on volunteers to fill up the army and the Guard if an emergency arose? [19] Debate centered about a plan proposed by Secretary of War Garrison, who proposed to build up over three years, as a supplement to the regular forces, a "Continental army" subject in all respects to federal control. Behind this plan lay the premise that the National Guard was not a satisfactory reserve force, and General A. L. Mills, chief of the division of military affairs, gave blunt testimony before Congress as to his inability to exercise the supervision which was specified by law. "The Organized Militia," he said, "consists today, not in a single army functioning in all its parts in obedience to a single superior authority, but an aggregation of 48 little armies, the majority of which are organized without reference to national needs and each of which jealously clings to certain State rights. . . ." [20] In short, the attempt of the federal government to purchase authority over the state troops had failed, and in the opinion of Mr. H. L. Stimson, who had been Secretary of War under President Taft, it would continue to fail, even if federal payments were increased,

[18] U.S., Report of the Chief, Division of Militia Affairs, 1908, p. 40.

[19] See John Dickinson, *The Building of an Army* (New York, 1922), chapter ii. Todd, in *Journal of the American Military Institute,* No. 3, p. 166.

[20] U.S., 64th Congress, 1st session, House Committee on Military Affairs, Hearings on a Bill to Increase the Efficiency of the Military Establishment of the United States, p. 883.

because it left the federal commander in chief "in the position of a benevolent adviser with no power to command. . . . The Federal Government can advise, can make general regulations, can scold and threaten to withhold the pay, but the vital functions of administration, of giving the orders and seeing that they are obeyed, is in the hands of the State Governors and their subordinates." [21]

The National Defense Act of 1916 and Selective Service

The plan of Secretary Garrison did not prevail. Against it was the National Guard Association, which feared that the Guard would be eclipsed, as well as those who feared expansion of the federal power. This group proposed instead to "federalize" the Guard by strengthening the policies embodied in the Dick act. The constitutional limitations upon the federal power could be circumvented by statesmanship—in particular by attaching conditions to federal appropriations for the Guard—and there was, so the argument ran, an advantage in having a citizen army.[22] This was the opinion which appealed to Congress and which was, in the main, embodied in the national defense act of 1916.

In many respects this legislation gave the federal government a larger control over the Guard. To remedy the unbalanced condition of the Guard in many states—for example, an excess of infantry and a deficiency of artillery because the former was cheaper to support—the president was empowered to prescribe the type of unit to be maintained and to group the units as he saw fit. State control over the appointment of officers was cur-

[21] *Congressional Record,* vol. 53 (1916), p. 5226.

[22] In an interesting soliloquy, Senator Chamberlain, the chairman of the Senate Committee on Military Affairs, declared: "It has always seemed to me, although I have never been able to figure it out, that limitations can be placed upon the appropriations by the Federal Government that would compel the National Guard to yield to Federal control." (U.S., 64th Congress, 1st session, Hearings, Senate Committee on Military Affairs, Preparedness for National Defense, p. 196.) Many spokesmen for the National Guard were agreeable to this approach. General O'Ryan summed up the "alleged defects" of the Guard system as follows: "That there are as many standards of professional qualifications for officers as there are States; that there are as many tenures of office as there are States or groups of States; that there is no uniform period of enlistment for the enlisted man; that the physical standards for enlistment vary throughout the country . . ." (p. 797). Then he insisted that the blame was to be put upon Congressional inaction and that if Congress wanted to secure uniformity in standards, and if it was willing to pay for them, there would be no difficulty.

tailed by setting up detailed standards to be fulfilled before federal recognition would be given; and the defect in the authority of the federal government with respect to use of the Guard outside the United States was remedied by requiring each officer and man to take, in addition to the state oath, an oath binding him to federal service. In a great many less important details there was to be federal prescription of standards and federal assumption of the costs. While no direct exercise of federal compulsion was possible, it was hoped that the desire of the states to cooperate, together with the threat of withdrawal of federal financial support, would be adequate to secure an effective citizen army without resorting to the more extreme centralization represented by the Garrison plan.

Before the new scheme was in working order the United States entered the war. At this time the strength of the regular army was 127,588 officers and men, and that of the Guard was 181,720. At once steps were taken to increase the number of men under arms by voluntary enlistment, and in addition Congress, after a sharp debate, passed the selective draft act.[23] All citizens between the ages of twenty-one and thirty years (inclusive), not specifically exempted, were declared eligible for military service, the quota of men to be drafted from each state to depend on state population.[24] But how was registration of the persons liable to draft to proceed? And how, after registration, was selection to be made? The precedent of the Civil War had placed administration in federal hands, but it was felt that this had been far from satisfactory, and the decision was taken to make a new departure by relying upon state and local agencies.[25] Registration was to be at voting precincts, and with this as a start, the whole organization was built up on state lines. The task of selection was handled similarly. The interesting fact, thus, is that the plan was framed and executed in full realization of the existence of federalism.

It is easy, after the event, to understand why decentralization worked so well. No only was the aim of the draft simple and

[23] This act was not passed until May 18, 1917.

[24] This was later changed to make the distribution depend upon the number of men available for draft service.

[25] See E. H. Crowder, *The Spirit of Selective Service* (New York, 1920), p. 118, for a description of how this idea originated, and chapter v for further information.

within the understanding of every citizen, but both registration and selection required knowledge of individual cases that could only be possessed by and secured from local sources. Therefore, small administrative units—boards—were essential, and these could, moreover, serve as "effective buffers between the individual citizen and the Federal Government." [26] Unquestionably the idea of using local and familiar agencies was a stroke of genius. Local administration, with national supervision and oversight, did the job more quickly and more effectively than would a plan which was entirely federal.[27]

Meanwhile, the president had used the power given him by the selective service act to draft the National Guard into the federal service.[28] The Guard and the regular army were greatly augmented by volunteers and by draft, and finally, in August 1918, the distinctions between the various forces were abolished, all being amalgamated into the "United States Army." [29] The National Guard was thus nearly forced out of existence, and when the former guardsmen were demobilized they were not returned to their former militia status. When discharged from the federal service, they were altogether out of the service.

Federalization of the National Guard

With peace, Congress turned once more to the question of the appropriate normal organization of its military forces, and once more a sharp conflict of opinion developed between the experts and the public, and among the experts themselves. On only one important question—the desirability of compulsory military train-

[26] Dickinson, *The Building of an Army*, p. 116, quoting General Crowder's Second Report.

[27] General Crowder, who was in charge of the administration of the draft, had high hopes that this scheme of coöperative federal-state administration might be widely extended to other areas of government. (See *The Spirit of Selective Service*, especially chapter xii.) As will be indicated, there have been other applications, but in few instances can we secure the same faithful and selfless participation of citizens as in war, and seldom will the task be so specific and so national as that of selective service.

[28] A number of officers and some men of the Guard were for physical or other reasons separated from the service. It should be noticed also that the constitutionality of the selective service act was affirmed by the so-called selective draft cases. In one of these (*Cox* v. *Wood*, 247 U.S. 3, 1918) the power of Congress to compel overseas military service was upheld, the militia provisions in the Constitution being declared not to limit the power of Congress to impose military duty.

[29] Dickinson, *The Building of an Army*, p. 85.

ing—did the experts appear to be in agreement, and this was the only thing which Congress, responsive to public opinion, omitted from the new legislation which was hammered out. The country was in a strong reaction against "preparedness" in any of the forms which the experts thought advisable; it desired to revert to "normalcy" with no compulsory military training of civilians and without even an enlarged regular army. Congress, therefore, bewildered by the babel of advice proposed to it by military men, turned back to the national defense act of 1916. The National Guard was reconstituted, under the militia clauses of the Constitution, so as to be a state force in normal circumstances and a part of the army of the United States when called into the federal service in time of emergency. The federal peace-time controls were somewhat tightened in an effort—to use the current phrase—to "federalize" the Guard.[30]

In the next two decades there can be no question that the Guard came more and more under federal auspices.[31] The policy begun many years before of buying control by assuming costs that had once fallen upon the states was carried to its logical conclusion. Whereas in 1915 the states spent $8,463,000 and the federal government $4,848,000 on the Guard, by 1923 the state figure was $10,836,000 and the federal figure was $22,357,000. Six years later, in 1929, the state expenditure had risen only to $11,435,000, while the federal expenditure had grown to $33,160,000; and ten years later, in 1939, state expenditure was approximately $11,861,000 and federal was $43,376,000. The federal government

[30] General O'Ryan, then as in 1916 a leading National Guard officer, made the following statement: "At the present time the National Guard is fundamentally and primarily a State force with a secondary and subordinate Federal role in time of peace. I would like to see that changed, so that its Federal role would be the dominant role, and its State role the servient role, but not under Regular Army auspices." (U.S., 66th Congress, 2nd session, Senate Subcommittee on Military Affairs, Hearings, Reorganization of the Army, p. 523.) It should be noticed that in the Senate some members regarded the 1920 act as an unconstitutional and objectionable expansion of the federal power.

[31] The Guard also comprised the largest armed force in the United States as the following figures show:

Strength of:	Regular Army	National Guard	Officers Reserve Corps
1925	134,624	177,428	94,013
1930	137,645	182,715	113,523
1935	137,966	185,915	112,590

Annual Report of the Chief of the National Guard Bureau, 1941, p. 3.

was supplying all the arms and equipment, and it provided pay to the guardsmen for an evening drill each week and a fortnight's field training each year. Officers and men from the regular army acted as instructors and inspectors of the Guard. In general, all Guard expenses had become federal except provision of armories and arsenals for training and for storing equipment.[32] No report of the Militia Bureau (the National Guard Bureau) failed to mention the progress made by the Guard, and only on rare occasions did complaints creep in. Yet it is an open secret that the Guard has many faults. In some states proper armories have not been provided; theft of federal equipment has never been eliminated; and variable standards of training and efficiency have prevailed, although in all states a minimum standard has been required. Supervision by the army keeps variation within limits, but performances are tolerated which would not be acceptable if the Guard were a purely federal force.[33] Some amateurishness, particularly among the officers, appears inevitable, and the fact that the Guard has a dual capacity makes for heterogeneity in standards. The militia character of the Guard has been very considerably overlaid, but it has not been removed, and the states have been zealous to retain some rights. Federalism has its effect upon the organization and training of the military forces of the United States.

[32] The principal items of federal expenditure for the Guard in 1938 can be seen in the following table:

	Millions of dollars
Pay for armory drill	14.1
Field training camps	9.2
Articles of uniform	2.4
Airplanes	2.4
Equipment—field guns	1.2
Equipment—signal corps	1.1
Caretakers	2.5
Ammunition	1.0
Other	5.8

[33] In *Notes for Regular Officers Detailed for Duty as Instructors with the National Guard* (Militia Bureau Document No. 913, Washington, 1925), the warning was given that "it cannot be expected that the National Guard can attain the same standards prescribed for the Regular Army during the limited time available for their training" (p. 4). "Remember the National Guard is purely a State force unless called into Federal service. . . . The Federal Government exercises control only through the allotment of funds for certain purposes, and, as its representative, you can only, by means of required reports, insure compliance with regulations which restrict the disbursement of these funds" (p. 14).

If one could argue that, in this respect, state participation had brought originality and vigor, which offset the defects of the Guard and helped reduce the routine and bureaucratic red tape of the regular army, then dualism would be justified. But the suspicion remains that we have tended to get the worst of both worlds. In times of emergency everyone admits that defense requires a national and unified policy; in the piping days of peace, this slips into the background, and the need of a national program is forgotten. The pacific attitude of the American people, the absence of neighboring nations strong enough to be a menace, the federal character of the country, make it easy to revert to a pattern in which the role of the states is acknowledged. Moreover, most people judge by results, and whatever may be the faults which the experts find in the past military organization of the United States, the outcome has always been fortunate, the emergency has been happily resolved, and the lessons which the experts would draw seem to lose their point.

There is, then, a danger that federalism has helped perpetuate an ineptitude in military organization which should be reformed. The constitutional difficulties are not the obstacle. In 1933 Congress passed legislation by which the Guard was organized and administered under the army clause of the Constitution rather than under the militia clause. The Guard was no longer to be drafted into the federal service as individuals; instead it was to be *ordered* in as units.[34] But traditions and precedents are not removed at once by legislation. And the Guard, when not called into the federal service, remains a state force with state duties, despite its federal pay, its federal equipment, and its conformity to federal standards. Some of these duties make the Guard a sort of political police force, and governors have even called out the Guard for anti-federal purposes. Thus in 1934 the governor of Arizona used the Guard to stop construction of a dam under contract with the government of the United States.[35] Surely the irony is acute when men maintained at federal expense are so employed, and it

[34] See F. B. Wiener, "The Militia Clause of the Constitution," *Harvard Law Review,* December 1940, p. 208.

[35] See Wiener, *op. cit.,* pp. 218–19 for several examples. Mr. H. L. Stimson as early as 1916 pointed out the confusion and difficulty which followed from making a member of the Guard a state policeman as well as a national soldier. It was his opinion that enlistments in the Guard were "mainly" held down by the liability to strike duty. See *Congressional Record,* vol. 53, p. 5226.

would appear that Congress should put some limits upon use of the guardsmen within state borders. Perhaps Congress, upon examination of all the issues, may decide upon still further steps toward centralization in military organization. One hundred and fifty years ago citizens might legitimately fear that a standing army would be a menace to democracy, and they might reasonably argue that the wars of the future could be fought by a militia. Such a fear and such an argument appear remote from the facts of the present.[36]

[36] After the passage of the selective service act of 1940, the Guard was inducted into the military service of the United States, but only after a considerable house-cleaning. Between July 23, 1940, and induction, the Guard lost over 94,000 men, approximately two-fifths of its previous strength (*Report of the Chief of the National Guard Bureau,* 1941, p. 18, p. 30). The most important factor was that all enlisted members of the Guard with dependents were discharged upon application, and these totaled one-fifth of the strength of the Guard. A variety of other factors—employment in key industries, attendance at college, physical disability when subjected to a strict examination—accounted for the rest.

CHAPTER IV

JUSTICE AND POLICE

It [Congress] may make a crime the use of interstate commerce by a fleeing criminal in order to aid the states in the apprehension of the guilty and make certain, swift and sure the punishment of those who commit crimes against the states. If such a power be not lodged in Congress, then the unity of our people is destroyed, and the states crippled in punishing those who violate their laws and flee to another state.[1]

THE APHORISM of Dicey that "federalism is legalism" indicates why the administration of justice is much more complex in a federal than in a unitary country. In the United States the Constitution stands above the legislature, and therefore certain legislation may be deemed by the courts to be outside the sphere of the federal power and within that of the states, or outside the sphere of the state power and within that of the federal government, or forbidden altogether. But the system of justice and law is not of equal complexity in all federal countries, and the system of Canada, for example, is simpler than that of the United States. In Canada there is only one body of law, and all judicial officers, even when provincially appointed, administer that law. All judges are appointed and paid by the Dominion government, although "the administration of justice in the province"[2] is a provincial matter. Criminal procedure is reserved to the Dominion, and the penitentiaries, as distinct from public and reformatory prisons, are under Dominion jurisdiction. A careful student of federalism has contrasted the situation in Canada and in the United States as follows: "So far as this very intricate situation can be summarized in a sentence, we may say that in Canada there is one body of national law subject to provincial variations, whereas in the United States there are forty-eight distinct bodies of state law together with a limited amount of common law relating to certain specified matters."[3]

[1] *United States* v. *Miller,* 17 F. Supp. 65 at 68—W.D. Ky.
[2] British North America Act, section 92.
[3] H. A. Smith, *Federalism in North America* (Boston, 1923), p. 112.

The Dual System of Justice

In the United States the federal courts are distinct from the state courts. Two separate jurisdictions exist, each with its own judges and officers, and each with a distinct sphere of action. The federal judiciary has no authority over the state courts and it can place no duties upon them. In practice the line of division between cases which are in the federal jurisdiction and those which are in state jurisdiction is blurred and conflict may arise, but the supremacy of the federal power is assured by the right of appeal to the federal courts in cases which "touch the safety, peace and sovereignty of the nation, or which presume that State attachments, State prejudices, and State interests might sometimes obstruct or control the regular administration of justice." [4] The broad jurisdiction of the federal courts is now firmly established,[5] although the Supreme Court has sometimes been more and sometimes less vigorous in the assertion of its powers. To this day the Supreme Court is cautious about upsetting the decisions of the state courts, not because of undue respect for state sovereignty, but because of "the deference due to the understanding of the local courts upon matters of purely local concern . . ." [6] and because of a realization that the divergent traditions and circumstances of the states must get some recognition in law.

And Congress, in making provision for the lower federal courts, has been sensitive to states' rights. In establishing judicial districts it has never crossed state boundaries, and district judges have generally been confined to the districts in which they were resident.[7] In 1922 an attempt was made to offset this localism in organization by setting up a judicial conference, consisting of

[4] James Bryce, *The American Commonwealth* (New York, 1910), I, 232–33, quoting Kent's *Commentaries*.

[5] There has been one instance of constitutional amendment to limit the right of appeal to the Supreme Court. In 1793 the state of Georgia, sued by two citizens of South Carolina, executors of a British creditor, was held liable for breach of contract in the case of *Chisholm* v. *Georgia,* 2 Dallas 419. This infringement of state sovereignty was resented and it was corrected by the eleventh amendment, ratified in 1798, which declared that "the judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another State, or by citizens or subjects of any foreign state."

[6] Felix Frankfurter and James M. Landis, *The Business of the Supreme Court* (New York, 1928), p. 16.

[7] *Ibid.,* pp. 218–19.

the Chief Justice of the United States and the nine senior circuit judges, which was to meet regularly for the purpose of surveying and improving the administration of the lower federal courts. While this reform has worked well, there is still complaint that the district courts have too much business, particularly of a sort which might better be left to the state courts.[8]

The other part of the dual system of justice in the United States—that of the states—shows much less cohesion and much more diversity than the federal. As long ago as 1850 a movement got under way designed to provide a remedy for the diversity of state legislation on important subjects. The most important influence has been exercised by the National Conference of Commissions on Uniform State Laws, organized in 1889. It drafts bills upon such subjects as uniform incorporation, or motor vehicle registration, or extradition, and recommends adoption by the states. In some fields, particularly commercial law, it has had considerable success,[9] and in recent years progress has in all fields been faster than ever before. Other agencies [10] exist which have made contributions in this field, but on the whole the outlook in the immediate future for voluntary coöperation by the states is not very hopeful. There is still an enormous amount of conflicting or at least divergent legislation. Furthermore, even when state legislation is uniform, the courts of the states do not give it uniform interpretation.[11] Here also efforts have been made to get reasonable uniformity. In the past decade there has been a rapid growth of the judicial council movement, but so

[8] *Ibid.*, p. 293. In 1925 another judicial reform attempted to shut off at the source the excessive flow of cases to the Supreme Court by giving the Court a large discretion as to the type of cases which were of sufficient public importance to come before it.

[9] In 1940 the uniform negotiable instruments act had been adopted by 53 jurisdictions, warehouse receipts by 49, sales by 35, bills of lading by 29, stock transfers by 27, partnerships by 20, limited partnerships by 22, conditional sales by 10, trust receipts by 9, uniform criminal extradition by 32, act to compel attendance of witnesses from outside a state in criminal cases by 22, narcotic drug act by 41, proof of statutes act by 25, declaratory judgments act by 28, veterans guardianship act by 35. *Proceedings of the National Association of Attorneys-General, 1940* (Chicago, 1940), p. 16.

[10] See W. Brooke Graves, *Uniform State Action—A Possible Substitute for Centralization* (Philadelphia, 1936), chapters iii and iv.

[11] Even upon issues brought to and decided by the Supreme Court, the state courts need not follow unless the interpretation of the supreme law of the nation is involved. *Ibid.*, pp. 270–71.

far it has had slight influence in securing uniformity of judicial procedure among the states.

Probably the most unfortunate, and certainly the most criticized conflicts of jurisdiction arise in connection with criminal justice. The content and procedure of criminal law differ from state to state, and attempts to secure uniformity and reciprocity have not made much headway. Sometimes, as in connection with extradition, the practice of the states is contrary to the express provisions of the Constitution, which declares (Article IV, section 2) that: "A person charged in any state with treason, felony or other crime, who shall flee from justice, and be found in another state, shall on demand of the executive authority of the state from which he fled, be delivered up to be removed to the state having jurisdiction of the crime." In fact, however, almost complete discretion rests with the governors, and they have often refused to accede to requests from other states for the return of a criminal.[12]

These few paragraphs must serve to indicate what is beyond controversy, that the system of justice and law in the United States is complex and expensive even for a federal country. The burden does not, however, fall chiefly upon governmental budgets.

[12] Graves, *Uniform State Action*, p. 95. The historic and extreme case of *State v. Hall*, decided by the North Carolina court in 1894, is summarized by John Barker Waite as follows: "Hall while standing in North Carolina deliberately shot and killed a man who was on the other side of the State line, in Tennessee. There was no manner of doubt that Hall was guilty of murder, as the killing was malicious and without excuse. A North Carolina jury convicted him and he appealed to the State supreme court. His argument was that the courts of North Carolina had authority to punish only persons who had committed crimes within the State; that while he had committed a crime while he himself was within the State, the crime itself had not occurred within the State of North Carolina, but in the State of Tennessee where the rifle ball struck the deceased and caused his death.

"The appellate court accepted this argument in its entirety; held that the murder had been committed in Tennessee and that the courts of North Carolina had no power to punish.

"Thereafter Hall was rearrested and plans were made to take him into Tennessee for trial in that State. But again Hall appealed to the North Carolina court. This time he asserted that no man can be forced to leave the State wherein he is and go to another State for trial unless he be a 'fugitive from justice' from that State. And again the North Carolina court saved him from punishment by the argument that one cannot lexicographically be a 'fugitive' from a place where he has never been; that although Hall had, by his bullet, committed a murder in Tennessee, he nevertheless had not been in Tennessee himself; and, not having been there, he could not have fled from there; hence he was not really a fugitive from justice and could not be extradited for trial in Tennessee. The result was that so long as Hall kept out of Tennessee he could not be punished for the murder he had committed." *Criminal Law in Action* (New York, 1934), pp. 261–62.

Rather do excessive litigation, conflicting state laws, disputes about jurisdiction, and so forth, put a direct expense upon business and individuals. While no measure of this expense can be secured, it is not without significance that the United States, with three times the population of England and Wales, has seven times as many lawyers.[13]

Law Enforcement

In any modern nation, the function of preserving law and order is much wider than that embraced in the work of the courts. Property and person have to be protected, regulatory measures have to be administered. Both in unitary and in federal countries these functions have, until recently, been left to local governments.[14] Not long ago the major tasks which the police were called upon to perform were local in nature, and a knowledge of local conditions was essential. But times have changed, and it is a matter of common observation that modern facilities of communication, modern weapons, and urbanization have strengthened the hands of the criminal and enlarged the effective area in which criminals can operate.

In England, the desirability of giving the police force a semi-national character was recognized over three-quarters of a century ago, and the national government began to give grants in aid to the localities, acquiring at the same time important powers of supervision. On various occasions both the grants and the supervision have been increased, and at present the grants amount to half the net expenditure on local police forces and wide control is exercised by the national government. Conditions of pay and of service are substantially the same everywhere, and although appointments, discipline, and administration are for the most part in local hands, the police force has been made a national and co-ordinated body for law enforcement.[15]

In the United States there has, of course, been no similar de-

[13] *Recent Social Trends* (New York, 1933), II, 1481.

[14] In Norman England, the local *area* in which a crime was committed was fined, unless it produced the criminal, on the premise that the area had a responsibility. The reversion to this practice by Germany in recent years is familiar to everyone.

[15] See R. B. Fosdick, *European Police Systems* (New York, 1915), pp. 39–64; A. L. Dixon, "English Police Systems," *Annals of the American Academy of Political and Social Science*, no. 235 (November 1929), pp. 177–92.

velopment, although in recent years centralizing influences have been at work.[16] State expenditure for police has grown as follows:

1915	$ 89,100
1923	4,130,900
1931	13,979,400
1937	26,470,900

This expansion has seemed necessary to protect, at one end of the scale, the rural communities against raids from criminal gangs, and at the other end, the city dweller against organized racketeering. But the development of state police forces and of coördination between them and local police forces within a state will not solve many of the serious problems of law enforcement because, while the jurisdiction of the state ends with state boundaries, the lawbreaker operates across state boundaries. The criminal may hide in a different jurisdiction from that in which he committed a crime, and even if he is returned for trial, there is the problem of getting essential witnesses out of other jurisdictions. Sometimes, where the boundary between states is a river, this has provided an area in which activities contrary to the laws of one of the states—or even of both—can be carried on with impunity.[17] An obvious remedy might seem to be the use of reciprocal agreements and interstate compacts; and in 1934 the federal government cleared the way for negotiation of compacts by passing legislation which gave blanket Congressional consent in advance to compacts among the states in the field of prevention of crime and enforcement of criminal laws.[18] There has, besides, been some development of coöperative state efforts in combating crime, and certainly, in this field, a theory of states' rights is decidedly unconvincing unless related to state responsibilities. Nevertheless, progress has been extremely slow. Some states refuse to be

[16] The earliest movement for police reform in the United States arose in the last quarter of the nineteenth century. Corruption in city police forces attracted wide attention, and the police force of many large cities was brought under state control. Unfortunately this very often meant that "the police department was merely lifted from one set of political influences into another" (R. B. Fosdick, *American Police Systems*, New York, 1920, p. 101), and in many cases the cities regained control of their police.

[17] See *Proceedings of the Attorney-General's Conference on Crime* (Washington, 1934), p. 65.

[18] Congressional sanction to interstate compacts and agreements is required by Article I, section I, clause 3 of the Constitution.

reasonable about issues which require interstate action, some lag behind their neighbors, some fail to interfere with city governments which tolerate criminal rings—Al Capone in Chicago seemed beyond the law of Illinois. During the 1920's a feeling arose that federal intervention was desirable and necessary, but the difficulties arising out of prohibition held back extension of federal activities in the field of law enforcement. Indeed, almost every move which it made was denounced as an illegitimate intrusion upon states' rights. Yet even before prohibition had been defeated, there was an astonishing reversal in public opinion. Depression brought a sharp increase in serious crime, and this created a demand for federal action to overcome state paralysis.

Recent Expansion of the Federal Power

The direct constitutional powers of the federal government concerning criminal-law enforcement are few. Counterfeiting, treason, crimes committed upon the high seas and navigable waters and on federal property fall within its jurisdiction. But in addition Congress has had to create and define a large number of crimes in order to carry out the enumerated powers conferred on it by the Constitution. "If Congress has power to lay and collect taxes, it becomes necessary and proper to prescribe penalties for the non-payment of taxes; and it is likewise in order to maintain a force of men to prevent and detect tax evasions. If Congress has authority to establish post offices, it may also protect these institutions from robbers, and, in order to do so, may maintain a force for inspection, investigation, and policing. So, too, it becomes appropriate for Congress to define as criminal the impersonation or assault of a federal officer, though the Constitution itself says nothing of assaults or impersonations. The authority of Congress to regulate interstate and foreign commerce has been used to penalize various acts for different purposes." [19] Gradually Congress appointed officers not merely to protect the various fields of federal administration, but to build up a general police power. Thus Congress in establishing and maintaining a postal system is not restricted narrowly to measures which affect efficient operation; it can deny and has denied the use of postal

[19] Arthur C. Millspaugh, *Crime Control by the National Government* (Washington, 1937), p. 45.

privileges for distribution of obscene literature, lottery tickets, seditious publications, etc., although these do not affect the efficiency of the system. The taxing power has been similarly used, as when, for example, in 1914 the Harrison narcotic act required all dealers to register with the collector of internal revenue and to pay a small annual tax of $1. The revenue motive behind this legislation was insignificant, yet the Supreme Court upheld its constitutionality. The commerce clause has been used even more widely to curb antisocial activities. One early measure which illustrates clearly the scope of the Congressional power was the Mann act of 1910; and in upholding its constitutionality the Supreme Court, speaking through Justice McKenna, made one of its most striking statements. "Our dual form of government has its perplexities, State and Nation having different fields of jurisdiction,...but it must be kept in mind that we are one people; and the powers reserved to the states and those conferred on the Nation are adopted to be exercised whether independently or concurrently to promote the general welfare, material and moral." [20]

It will, perhaps, be worth while to notice the most important task of law enforcement ever placed upon the federal government—that arising out of the eighteenth amendment—because in no other instance were the difficulties of federalism so clearly in evidence. The efforts of the "drys" date back many years before 1919. Striving at first to make progress through state and local legislation, the reformers received a sharp check by decisions of the Supreme Court in 1888 and 1890 [21] which held that statutes prohibiting the sale, manufacture, and transportation of intoxicating liquors did not prohibit their transportation into a state. This made state prohibition a farce, and it appeared that the commerce power had overridden the state police power. The "drys" now shifted their efforts from the state to the national field and insisted that Congress give the states the right to make regulations about liquor moving in interstate commerce. The first response of Congress—the Wilson act of 1890—was a failure, and not until 1913 was legislation enacted which clearly allowed the states to protect themselves against interstate shipments. The Webb-

[20] *Hoke* v. United States, 227 U.S. 308, at 322.

[21] *Bowman* v. *Chicago and Northwestern Railway Co.*, 125 U.S. 465; *Leisy* v. *Harden*, 135 U.S. 100. See Lindsay Rogers, "Interstate Commerce in Intoxicating Liquors before the Webb-Kenyon Act," *Virginia Law Review*, February 1917.

Kenyon act, passed over a presidential veto, divested intoxicating liquors "of their interstate character" and placed regulation squarely upon the states.[22] The eighteenth amendment, of course, made enforcement of prohibition a federal responsibility, although it declared that the states "shall have concurrent power to enforce this article by appropriate legislation." Concerning this provision and its results one authority has made the following pointed comment: "For the first time, it is believed, the states were requested by the federal Constitution to enforce one of its provisions; for the first time overlapping and duplication in administration were given express constitutional endorsement; and, also for the first time, the national and state governments were invited by the highest authority to 'pass the buck.' The results are still fresh in our memories. An error in policy produced an impossible administrative situation. Certain of the states failed to assume their share of the task and shifted the distasteful burden to the broad but slightly stooping shoulders of Uncle Sam. Prohibition leaders, misled by unwarranted faith in the omnipotence of federal enforcement, abandoned the localized methods which had gradually created a substantial temperance sentiment."[23]

It seemed for a time that the efforts of the federal government to enforce prohibition had raised a violent sentiment against centralization. There had been a multiplication of federal officers who were overbusy and who did not command public respect. The gross cost of federal enforcement of prohibition was estimated in 1930 at $39,691,000,[24] and this seemed an outrageous sum. Yet at this very time when, on the surface, the national reaction to extension of the federal police power seemed most adverse, forces were at work which brought about a sharp shift of opinion. The breakdown of prohibition and the continuance of depression evoked a startling outbreak of lawlessness which state and local officers seemed impotent to curb. The climax came with the Lindbergh kidnapping, and Congress hastened to pass

[22] The Supreme Court upheld the act by its decision in *Clark Distilling Co.* v. *Western Maryland Railway Co.*, 242 U.S. 311.

[23] Millspaugh, *Crime Control by the National Government*, p. 54. The twenty-first amendment did not throw liquor control back to the states, since it instructed the federal government to protect those states which choose to remain dry. So far the states have been apathetic toward liquor control, and it has been suggested that federal grants in aid be used to foster coöperative federal–state enforcement activities. L. V. Harrison and E. Laine, *After Repeal* (New York, 1936), p. 228.

[24] *Recent Social Trends in the United States* (New York, 1933), II, 105.

the so-called Lindbergh law which made it a federal crime to transport a kidnapped person across state or national boundaries, and the federal extortion act which made it a federal offense to send extortion letters through the mails. When Homer C. Cummings became attorney-general, an enlarged program for crime control was framed and the 73rd Congress passed seven statutes which created new federal crimes and three which enlarged existing substantive crimes.[25] None of this legislation has been declared unconstitutional, and it was the contention of Mr. Cummings that he meant merely to bar the neutral corridor between federal and state jurisdiction "in which criminals of the most desperate character found an area of relative safety."[26] It was also a part of his program to extend federal–state and interstate coöperation by encouraging reciprocal legislation, and here also remarkable progress was made.[27]

The passage of legislation creating new federal crimes required, of course, the enlargement of federal facilities to enforce the laws; and here, as the nation has become aware, the Federal Bureau of Investigation was the answer. The Bureau, established in 1908, was for many years an unobtrusive part of the law-enforcement machinery. In 1931–32 its expenditure was only $1,973,000, but by 1937–38 this had risen to $6,440,000, and by 1939–40 to $8,371,000. The Bureau has become the chief police force of the federal government and has been engaged mainly in the general suppression of crime. The spectacular results achieved in a few brief years—sharp curtailment of kidnapping and bank robberies, "liquidation" or imprisonment of the most important "public enemies"—have been nationally recognized. And the Bureau has done much work which supplements the activities of state and local officers. A file of fingerprints is maintained at Washington and from it law-enforcement officers over the nation can secure prompt information which may identify a criminal.

[25] See *The Crime Laws of the 73rd Congress* (Washington, 1934); also *Handbook on Interstate Crime Control,* by the Interstate Commission on Crime (Newark, 1938), chapter vii; also *Law and Contemporary Problems,* vol. I, no. 4, "Extending the Federal Powers over Crime."

[26] H. C. Cummings and C. McFarland, *Federal Justice* (New York, 1937), p. 481.

[27] See *Handbook on Interstate Crime Control,* p. 2. In 1937 the states were operating under coöperative uniform crime-control legislation or compacts as follows: Fresh pursuit 23, extradition 28, out-of-state witnesses 36, interstate parole and supervision of probation 26, firearms 9, narcotic drugs 40.

At Washington also is conducted a National Police Academy "for law-enforcement officials, covering administrative features of public work, discussion and consideration of every-day police problems, and practical training in enforcement duties." [28] Mr. J. Edgar Hoover, the Director of the Bureau, has said that the Academy

> removes the argument for the establishment of a national police, which I think is impractical and undesirable. It gives to the local authorities the same control they have now, plus the benefit of additional training, and does not superimpose upon them any bureaucracy from Washington. Added to that fact, it bridges over that gap between local and federal law-enforcement officers, which is very important. It eliminates the jealousies that sometimes exist and helps to do away with friction which may develop.
>
> We feel that if a man will come here and live with us for three months, go to Quantico and camp there for a week and take our gun training, that man will go back thoroughly conversant with our problems. He will be able to speak our language and we will be able to speak his language. . . .[29]

It seems certain that the limits of the coöperative and coördinating work of the Bureau have not yet been reached, and that even its duties in general law enforcement should be expanded. There is a danger of overlapping and wasted effort, since officers of each of the levels of government may act independently in the pursuit of criminals. It is, of course, true that the most dangerous criminals commit offenses against all governments—federal, state and local—and that when Illinois and Chicago failed to punish Al Capone for serious crimes against them, the federal government was justified in putting him in Alcatraz for violation of its tax laws. In this, however, there is not merely a bitter irony, but also the prospect that genuine state and local effort may be duplicated or even supplanted. The remedy is plain. "Where unity in a common purpose is impossible, coöperation and coördination become indispensable." [30]

The heart of the crime problem consists of offenses which are within state and local jurisdiction. There are ten violations of state law to one of a federal statute, and no remedy for crime can be found which does not place a primary responsibility upon the

[28] Millspaugh, *Crime Control by the National Government*, p. 112.

[29] *Ibid.* The F.B.I. also provides instructors in special subjects for state and local police schools. Moreover, in 1938 the Office of Education extended aid to police-training programs, using funds provided through the George–Deen Act of 1936.

[30] *Ibid.*, p. 59.

states and localities. Crime prevention, even more than law enforcement, must be locally applied because it calls for local contacts, local knowledge, and adaptation to diverse local conditions. A primary step toward crime control would be taken

by centralizing law enforcement *within* the states through the creation of state police departments and allocating to such departments the criminal-law enforcement functions of the counties and municipalities, except possibly a few of the most populous ones. If this were done, we should have perhaps a hundred police forces, instead of tens of thousands; co-ordination among the states would be enormously facilitated; and the police organization of each state would be simplified, lifted out of its various dark pockets, and brought fully into the spotlight, enabling an easier appraisal by state and national opinion of its efficiency and adequacy. According to available evidence, merely the establishment of a state police brings a substantial improvement in law enforcement, perhaps a greater improvement than has resulted from any expansion of federal activities.[31]

It may be that there is room for the device of federal grants to facilitate this desirable development.[32] More efficient and more coördinated law enforcement would not only decrease the tribute which the nation pays to criminals, but also would decrease the total cost of police. The danger of undue federal invasion of the powers of the states, and the further prospect that individual freedom will be unduly curtailed, are slight. Some years ago the late Justice Holmes remarked that "at the present time in this country, there is more danger that criminals will escape justice than that they will be subjected to tyranny." [33] So far no adequate remedy for this danger has been provided.

[31] *Ibid.*, pp. 287–288. Since 1930 every state has acquired some sort of police force, but in less than half the states does the force have general police power. Bruce Smith, *Police Systems in the United States* (New York, 1940), p. 187.

[32] A few writers have mentioned the possibility of federal grants without making specific suggestions. See Sanders, "Federal Aid for State Law Enforcement," *Law and Contemporary Problems,* October 1934. It is to be observed that any *state* grant-in-aid plan which aims at bringing local police under state control faces the difficulty that the police forces of cities are sometimes run more efficiently than they could be expected to be under state direction.

Bruce Smith, a very competent student of police systems, is pessimistic concerning the prospects of reform by the use of grants, fearing that bad units and defective organizations might thereby be perpetuated. *Op. cit.*, pp. 348–349. This is always a danger associated with grants for established governmental activities, but the danger is avoidable. The English experience here would appear to offer valuable suggestions for our guidance.

[33] *Selected Papers of Homer Cummings,* edited by C. B. Swisher (New York, 1939), p. 24.

CHAPTER V

EDUCATION

The inequalities of educational opportunity that characterize the educational system today constitute a challenge to American statesmanship.[1]

IN THE PRECEDING PAGES a brief examination has been made of two contrasting governmental functions, defense and law enforcement. Defense is primarily a duty of the federal government, although in a federalism the states have retained a vestigial share; law enforcement is primarily a task of the localities and states, although a national responsibility exists which, while small in terms of relative cost, is not unimportant. The functions to be examined next—education and social welfare—belong in still another category. In terms of finance they are in-between functions for which the financial responsibility is shared somewhat more evenly by the different levels of government. There has, in recent decades, been a trend toward centralization. In 1932, of a total expenditure of $2,137,600,000 for education, the localities provided 72.5 per cent, the states 25.4 per cent, and the federal government 2.1 per cent; in 1938 with a total expenditure of $2,437,000,000 these figures had changed to 58.2 per cent, 33.6 per cent, 8.2 per cent; and in 1941, with a total expenditure of $2,547,000,000, to 57.6 per cent, 36.0 per cent and 6.4 per cent. With respect to welfare functions the shift has been much more startling.

That federalism has had an important influence upon the financing of education can be brought out by contrasting the situation in Great Britain with that in the United States. In Great Britain the national government bears nearly half of the total cost of education by use of a complex system of grants in aid.[2] This system is over a century old, and since 1900 more and more attention has

[1] U.S., Advisory Committee on Education, *The Federal Government and Education* (Government Printing Office, Washington, 1938), p. 30.

[2] Figures for England and Wales can conveniently be found in H. R. Bowen, *English Grants-in-Aid* (Iowa, 1939), pp. 38–39, p. 107.

been given to allocating the grants to take some account of local educational need, although local rates for education still vary markedly. Aside from the deficiency in equalization, the major criticism of the British grants has been that the central government, through the Board of Education, has kept too tight a rein upon the local authorities and that this has dampened local enthusiasm and hindered the adoption of progressive ideas. The Board, without an intimate knowledge of local needs and unreceptive to experiment, has tended to become a financial machine. What is required is use of a "block" grant, given with a minimum of conditions and framed so as to increase equalization. There is a limit beyond which equalization cannot go, since local governments, in order to be wisely thrifty as well as wisely liberal, should raise from their own sources an appreciable percentage of their expenditure. But that limit has not yet been reached.[3]

Land Grants

Inspection of the relatively small financial contribution for education made by the federal government of the United States fails to indicate the real extent of the federal effort. No function of government, aside from such essentials as defense and justice, received more sympathetic consideration than education in the early days of the nation.[4] The famous ordinance of 1787 affirmed that "religion, morality and knowledge being necessary to good government and the happiness of mankind, schools and the means of education shall be forever encouraged"; [5] and its predecessor, the ordinance of 1785, provided that section 16 of every township of the federal domain should be set aside for the "maintenance of public schools." When in 1802 Ohio was admitted as a state, Congress declared that section 16 in every township was to "be granted to the inhabitants of such townships for the use of

[3] See John Corlett, *Financial Aspects of Elementary Education* (London, 1929).

[4] In colonial times as well, education received significant governmental support. Governments then were rich only in the possession of natural resources which would become valuable with settlement, and they endeavored to attract settlers and to encourage education by providing land endowments as a means of support for schools. The first permanent colonial school fund, that of Connecticut established in 1733, was based upon land. See Joseph Schafer, *The Origin of the System of Land Grants for Education* (University of Wisconsin Bulletin, No. 63).

[5] Ordinance of 1787, third article.

schools"; [6] and other states later received the same provision. Altogether this provided an endowment for public schools of 11,000,000 acres. Two deviations from the Ohio basis should be noticed. When in 1816 Indiana was given the sixteenth section, the recipient was the *state*, for the use of the inhabitants of the township; and when in 1837 action was taken with respect to Michigan, the grant was to the *state* for the support of schools with no reference to township lines. In short, control and responsibility were shifted from the township to the state itself.[7] In 1848 Congressional generosity was extended, since states created thereafter out of the Oregon territory were given sections 16 and 36,[8] and under this provision fourteen states received 43,900,000 acres. Three states—Utah, Arizona, New Mexico—received four sections (16, 36, 2, 32) in every township, a total of 22,600,000 acres, because of the small value of their lands. Altogether, then, twenty-nine states have received 77,500,000 acres from the federal government as an endowment for common schools, and miscellaneous other grants raised the amount of the public domain used for this purpose to 130,000,000 acres.[9]

It is a matter of common knowledge that this endowment was not always wisely used.[10] In theory the states held the land in trust and Congress assumed no responsibility. In most cases a permanent public-school fund was set up, the income of which was used for school purposes. But some states sold in

[6] John Randolph of Virginia voiced a general feeling which linked settlement and education when he said: "I believe that the appropriation, while it protects the interests of literature, will enhance the value of property. Can we suppose that emigration will not be promoted by it, or that the value of lands will not be enhanced by the emigrant obtaining the fullest education for his children?" *Annals of Congress,* 7th Congress, 2nd session, p. 586.

[7] The Michigan type of grant was followed for 20 states, the Illinois type for 4, and the Ohio type for 5. See J. M. Matzen, *State Constitutional Provisions for Education* (Teachers College, Columbia University, New York, 1931).

[8] This general statement needs some qualification. See Matzen, p. 100.

[9] *Encyclopedia of the Social Sciences,* IX, 34, "Land Grants, United States," by B. H. Hibbard. The original thirteen states, and also Maine, West Virginia, Kentucky, Vermont, and Texas received no land for this purpose because the federal government had no domain within their boundaries. But Texas, before joining the union, had set aside lands for the support of schools, and Tennessee, granted its lands by Congress in 1806, also set aside one section in every township. See P. J. Treat, *The National Land System, 1785–1820* (New York, 1910), pp. 272–273.

[10] G. W. Knight, "History and Management of Federal Land Grants for Education in the Northwest Territory," *Papers of the American Historical Association,* vol. I (1886).

haste and for low prices; some failed to invest and protect the funds obtained from sale; some diverted the funds to other purposes. Only a few sold carefully and invested wisely. There is a temptation to lament the squandering of a magnificent endowment, and to wish that Congress had insisted upon strict conditions or had even kept control of the endowment in its own hands.[11] Against this, it should be noticed, no *constitutional* obstacle existed. But pretty plans about what might have been do not take account of the temper of the times. Congress was in no mood up to the Civil War, and for several decades afterwards, to lay any conditions upon the states; and only an optimist can have a conviction that Congress, until nearly the twentieth century, would have been a better trustee than the states themselves. Moreover, the states which sold their lands early (not corruptly) at a low price were not wholly wrong. They could believe that cheap land, which brought settlers, would create taxable wealth to support education and all the functions of government; and that to hold back and wait for settlement was timorous defeatism. The pioneer states had, besides, to provide schools as the settlers appeared. A long view for the future was a luxury which they could not afford.

Grants of the federal domain have also been given as an endowment for higher education. In 1787, as part of a private bargain with the Ohio Company, Congress gave two townships for the use of universities, and Ohio University was founded as a result. This policy was soon generalized, with important deviations in the direction of greater generosity.[12] Altogether, the twenty-nine public-land states have been given over 2,600,000 acres of land for university support, in addition to the land grants made under the Morrill acts. Moreover, ten states, all admitted since 1889, have received grants totaling 1,360,000 acres for the establishment and support of state normal schools.[13]

[11] In Canada this latter was done with excellent results.

[12] Thus Ohio and Indiana each received three townships; Alabama, Florida, Wisconsin, and Minnesota each received four; and a number of states received additional specific grants for university purposes.

[13] A few of the other federal grants can only be mentioned. When in 1818 Illinois was admitted to the Union, it was given—as were other states—5 per cent of the net proceeds of land sales within its boundaries. But the act directed also that 3 per cent of this should be used "for the encouragement of learning, of which one-sixth part shall be exclusively bestowed on a college or university." With consid-

The Land Grant Colleges

Meanwhile, the idea had grown that the public lands should be used to assist education outside the states in which the lands were situated.[14] In 1857, Justin S. Morrill proposed that a land grant be given each state for the establishment, endowment, and maintenance of agricultural and mechanical colleges. This proposal encountered opposition from the South because of the slavery issue and from the West because of the belief that the eastern states had no right to western lands.[15] His bill was passed by Congress in 1859 only to be vetoed by President Buchanan. But when in 1862 the southern states were no longer represented in Congress, and when the west had been appeased by the Homestead Act, Morrill's scheme was accepted.[16] By it each state (and each new state as admitted) became "entitled to as many times 30,000 acres of public land (not mineral bearing) as it had in 1860 or had, at the time of its admission, representatives in both houses of Congress." States without public land within their borders were to receive scrip. The interest on not less than 90 per cent of the gross proceeds from the grant was to be used "for the endowment, support and maintenance of at least one college where the leading object shall be, without excluding the scientific and classical studies, and including military tactics, to teach such branches of learning as are related to agriculture and the mechanical arts."

erable variation in detail, most of the public-land states, voluntarily or involuntarily, have applied part of their 5 per cent funds for the support of education. Another money grant dependent upon sales of the public domain was started in 1908 when it was provided that 25 per cent of the income received from each forest reserve should be paid to the state in which the reserve is located to be used for the support of education and roads. This annual payment at present amounts to about $1,425,000 and it is received by thirty-nine states and Alaska and Puerto Rico. Again, by the mineral leasing act of 1920, "an amount equal to 37½ per cent of the receipts from bonuses, royalties, and rentals from mineral lands in the public domain is paid to the state within whose boundaries the leased lands or deposits are located." These sums are to be used for the support of education or roads, and in 1937 fifteen states were paid $1,944,600. (*Federal Funds for Education, 1937–38* (U.S. Office of Education, Washington, 1939, p. 22).) Some miscellaneous federal land grants have been used in support of education without any Congressional specification.

[14] The project of establishing a national university was endorsed repeatedly by presidents from Jefferson on.

[15] Henry Clay attacked the Morrill bill as an affront to state sovereignty because it undertook to specify the use to which the lands were to be put.

[16] For the history of the land grants to education see Earl D. Ross, *Democracy's College, the Land-Grant Movement in the Formative Stage* (Ames, Iowa, 1942).

This was the beginning of the land-grant colleges through which federal aid was given for a special type of education supposedly neglected at the time. By the first Morrill act 10,400,000 acres of land were provided as an endowment, and once again much of this was sold too soon and too cheaply.[17] In the early years the revenue derived from the first Morrill act was exceedingly important to many land-grant colleges; but, as will be indicated, new sources of income were later provided. In 1937 the total income received by the sixty-nine land-grant institutions because of the first Morrill act was $1,010,000, and only one state, Minnesota, received more than $60,000.[18] A second Morrill act was passed in 1890. It added to the endowment of the land-grant colleges by providing for each state an annual grant of $25,000, to be secured from the sale of public lands. But when the prospect arose that land sales would not cover the grant, an act was passed in 1898 which declared that any deficiency was to be met from the federal treasury. In 1908, by the so-called Nelson amendment, the grant for each state was doubled,[19] and therefore each of the forty-eight states, and Alaska, Hawaii and Puerto Rico, received $50,000 a year—a total of $2,550,000. Finally, in 1935, by the Bankhead-Jones act, additional annual grants were authorized totaling $980,000 for 1935–36 and rising by $500,000 a year to a maximum of $2,480,000 for 1939–40. Thus in summary the land-grant colleges receive as federal grants for resident instruction over $6,000,000 a year from the following sources:

Morrill act of 1862	$1,000,000
Morrill act of 1890 and the Nelson amendment	2,550,000
Bankhead-Jones act	2,480,000
Total	$6,030,000

The Bankhead-Jones act, besides making a sharp increase in grants, breaks with precedent in the basis of allotment. The first Morrill act distributed the federal bounty roughly according to

[17] The act required that a college be set up within five years if a state was to receive the grant, and this practically forced many states to sell. In 1889 Congress declared that new states were not to sell at a price of less than $10 per acre.

[18] George A. Works and Barton Morgan, *The Land-Grant Colleges* (Staff Study No. 10 prepared for the Advisory Committee on Education, Washington, 1939), pp. 13, 16.

[19] The 1890 grant began at $15,000 and rose by annual increments of $1,000 until it amounted to $25,000. The 1908 grant rose from $25,000 to $50,000 by annual increments of $5,000.

population of the states, but succeeding measures in 1890 and 1908 gave the same flat sum to every state and territory. This basis was unfair to the more populous states and therefore, by the Bankhead-Jones act, the increased grants were split in two. One portion, totaling $980,000, was to provide for a flat annual grant of $20,000 to each of the states; the other portion was to be alloted according to population. If it be asked why the large increase in grants was provided in 1935, the answer is to be found in three principal factors. There was, first, the pressure of depression upon the colleges, to which was added, as a second factor, the burden of extra demands placed upon the colleges as a result of the agricultural program of the federal government. Finally, the new federal policy of liberal spending led to the belief that it was reasonable to increase a type of grant which had been stationary in amount for a quarter of a century.

This is not the place to appraise the accomplishments of the land-grant colleges in higher education. It is claimed for them, with some justice, that they "greatly accelerated" the movement towards increased offerings of scientific and applied subjects.[20] On the debit side, it is pointed out that the federal government, "by concentrating aid to higher education in the land-grant colleges, is partially responsible for some of the internal conflict and diffusion of energy that now takes place in higher education."[21] In states where the land-grant colleges are separate from the state universities there is unnecessary duplication in research and in curriculums. No good reason can be offered why the land-grant colleges should be regarded as the special agencies of the federal government in higher education, and if, as has been suggested, federal grants for higher education are expanded, they ought not to be confined to the land-grant institutions.

In conclusion, two features of these federal grants should be noticed which are of some significance. First, the Morrill acts and their supplements made outright donations to the state governments with no provision for state matching. Yet the actual sums provided by the states to the land-grant colleges for resident instruction have, for many years, greatly exceeded the amount of the federal grants. Second, the Morrill act of 1890 was the first federal-aid measure which provided for withholding of grants

[20] Works and Morgan, *The Land-Grant Colleges*, p. 94.
[21] *Report of the Advisory Committee on Education* (Washington, 1938), p. 152.

from those states which failed to comply with federal conditions. In this particular case the power has never been exercised, but a precedent was set which was to be followed in most subsequent grant legislation.

Experiment Stations

The federal government, besides giving grants for resident instruction, has made the land-grant colleges the administrative centers of a series of other grants in aid for agricultural education. These grants have been for two main purposes: (1) agricultural research through the experiment stations, and (2) the extension service.

Twenty-five years after the passage of the first Morrill act, the federal government in 1887 started a new type of federal aid by providing, through the Hatch act, a grant of $15,000 a year for each state to establish an agricultural experiment station. By this act the only federal condition was the submission annually of a financial report; but eight years later, in 1895, an important step was taken in the direction of increased federal control when statutory provision was made for federal audit. Since then "no system for the administration of grants has been established in which there has not been some arrangement for an examination of state accounts, either on the basis of specific or implied statutory authority." [22]

The grants of the Hatch act have been supplemented by later legislation. In 1906 the Adams act doubled the annual allotment for each state; and in 1925 the Purnell act trebled this allotment, bringing the grant per state to $90,000,[23] and the total for all the states and territories to $4,492,500 (that is $4,320,000 for the forty-eight states plus $80,000 for Hawaii, $70,000 for Puerto Rico, and $22,500 for Alaska). These grants for experiment stations provided a flat amount for each state with no matching requirement.

In 1935, by the Bankhead-Jones act, Congress provided increased grants for, and a change in the basis of distribution of, the aid to experiment stations. Beginning in 1936, $600,000 a

[22] V. O. Key, Jr., *The Administration of Federal Grants to the States* (Chicago, 1937), p. 110.

[23] The additions made by both acts were spread over a period instead of being jumped in a single year.

year was to be added to the grants, with an increase of $600,000 a year to a maximum of $3,000,000 in 1940. Behind this very large addition were the factors already mentioned—the curtailment of state and local appropriations because of depression, the general loosening of the purse-strings at Washington, and the feeling that the federal government might well increase this, as well as other, expenditures for agricultural purposes. But Congress felt also that the plan of making a uniform flat grant to each state needed alteration, and it, therefore, provided that the new sums were to be apportioned according to rural population and that they were to be matched. These were desirable changes. Distribution according to rural population may not be ideal, but certainly it is an improvement over the plan which alloted to each state a uniform amount. And if state and local governments are to administer a function, they ought to put up an appreciable amount of the expenditure from their own sources. A 50–50 basis is not likely to be ideal, but it should be noticed that this is not required with respect to the *total* grants for experiment stations. The 50–50 basis applies only to the *new* grants provided by the Bankhead-Jones act, and the older grants do not have to be matched.[24] The table given below shows that after 1910 the

TABLE 5

INCOME OF EXPERIMENT STATIONS, BY SOURCES[a]

(thousands of dollars)

Fiscal year	Federal grants	State appropriations	Other sources[b]	Total
1890	$ 625	$ 227	$ 94	$ 945
1900	720	247	204	1,171
1910	1,343	1,320	873	3,536
1920	1,440	3,594	2,597	7,631
1930	4,335	8,807	4,769	17,911
1937	5,611	7,445	4,629	17,685
1940	6,849	9,408	4,960	21,217

[a] Works and Morgan, *The Land-Grant Colleges*, p. 39; U.S. Department of Agriculture, Office of Experiment Stations, Annual Reports on the Agricultural Experiment Stations.

[b] Includes individual and community contributions, fees, sale of farm products, previous balances, etc.

income which the stations as a whole received from the federal government was exceeded by that received from state appropriations. These over-all figures, however, conceal the wide variation

[24] As the table given above shows, state appropriations have been increased in order to secure the new grants.

in the positions of the different states. In 1940 the appropriations made by some states (see table) were only a small portion of their federal grant; at the other extreme states were appropriating eight dollars for every federal dollar.

TABLE 6

INCOME OF EXPERIMENT STATIONS IN SELECTED STATES IN THE FISCAL YEAR 1940

	Federal grants	State appropriations	Other sources	Total	Federal grants	State and other appropriations	Total
	(thousands of dollars)				(per cent)		
Rhode Island ..	$ 92.3	$	$ 7.1	$ 99.4	93	7	100
Nevada	92.5	3.4	13.0	108.9	85	15	100
Delaware......	95.0	26.7	19.9	141.6	67	33	100
New Mexico ...	103.8	13.8	54.7	172.3	60	40	100
New Hampshire	98.4	8.4	61.0	167.8	59	41	100
California	155.9	1,181.0	277.8	1,614.7	10	90	100
New York.....	179.8	1,081.2	127.8	1,388.8	13	87	100
Ohio..........	183.0	426.4	491.0	1,100.4	17	83	100
New Jersey....	120.5	499.6	51.8	671.9	18	82	100
Texas.........	239.4	410.3	365.3	1,015.0	24	76	100

There has always been grave doubt in the minds of agricultural specialists as to the wisdom of carrying on research through establishment of an experiment station in every state. Inevitably this procedure has led to duplication of effort. In an attempt to minimize this duplication, the Office of Experiment Stations of the Department of Agriculture was set up with the task of reviewing the research projects of the stations. But its success has been meager. Initiation of projects is the job of the state stations, and they, because of a limited outlook and because of state and local pressures, have often made selections of no national or regional significance.[25]

In recent years, the federal government has developed coördinated programs in which it participates with the state stations; and it has also assumed a more vigorous leadership in research

[25] In New England, the stations have coöperated in the development of agricultural research, and the federal government has encouraged the spread of this movement. See Works and Morgan, *The Land-Grant Colleges*, p. 37; Key, *Administration of Federal Grants*, p. 47.

by establishment of regional laboratories through funds authorized by the Bankhead-Jones act. Although wasteful duplication is less now than in the past, it is by no means eliminated, and the broad issue remains: Can agricultural research best be secured through a grant-in-aid program along the lines provided? Until 1935 each state received an equal share of the federal appropriations, and in some states this was supplemented only by a modicum of state funds. As a result, stations deficient in equipment and personnel were set up. Provision of agricultural research in areas, which cannot themselves support it, may be for the national interest; and in such cases the federal government should see that the job is done. But dispersion of federal funds for agricultural research in every state and territory, with administration by state officers, has been a wasteful process.

The Office of Experiment Stations, which is in charge of federal administration of these grants, has been more active and especially more forthright in withholding and suspending grants than similar federal agencies.[26] Sometimes it has acted by the formal method of refusing to certify to the treasury that the grant should be paid, in which case there has to be an appeal to Congress and congressional action before coöperative relations are resumed. This is a procedure suitable for extreme cases where a state has ignored repeated warnings and protests, and it has been used in two instances. In 1918 the grant for the Georgia station was not certified because of a long record of poor work and because the station was not connected with the land-grant college. Despite the obvious evidence of non-compliance with the federal act, Congress refused to support the Office of Experiment Stations and the Secretary of Agriculture. In 1929 the Oklahoma grant was similarly withheld after abrupt removal by the governor of key members of the station staff. For years the rate of turnover of the staff had been high, as had that of the entire college.[27] The withdrawal, together with the unfavorable publicity given to the episode, led to improvement; and Congress, at the request of the Secretary of Agriculture, restored the grants. More frequently

[26] Key, *Administration of Federal Grants,* p. 162.

[27] "There had been twelve presidents of the college from 1891 to the end of 1928; the turnover of the college faculty (including the experiment station staff) had reached peaks of 41.7 per cent in 1901, 58.3 per cent in 1908, 36.8 per cent in 1914, 42.2 per cent in 1921, and a mere 20.7 per cent in 1927." Key, *Administration of Federal Grants,* p. 164.

the Office of Experiment Stations has temporarily suspended payment of grants for offenses similar to those just noticed,[28] and still more frequently it has disallowed particular items of state expenditure. The most awkward problems of financial administration have arisen in states where the bulk of the income of the station has come from the federal grant. One may therefore charge against a scheme which provides federal aid of an equal amount for each state and without state matching, that it tends to create embarrassment. The states which are rich enough and interested enough to overmatch the federal grants do not need to be bound by conditions; those in the opposite situation do. This variation in state provision and attitude, which is a problem under the best of circumstances, is here aggravated.

Extension Service

The third major division of agricultural education for which the federal government gives grants is the coöperative agricultural extension service. As research in agriculture expanded through the work of the experiment stations and of the Department of Agriculture, the feeling grew up that something should be done to carry the results to the farmer. The land-grant colleges and the Department of Agriculture made beginnings by organizing farmers institutes and by demonstration programs. Then in 1914 the Smith-Lever act was passed providing grants, administered by the land-grant colleges, to give instruction and practical demonstrations in agriculture and home economics to persons outside the land-grant colleges. Each state was to receive a minimum of $10,000 a year plus a share, determined by rural population, of a further sum which began at $600,000 and increased to a maximum of $4,100,000 by 1922. The flat grant was not, but the remainder was, to be matched. Thus in its basis for allotment, and in the matching requirement, the Smith-Lever act was unlike the Hatch act, the Adams act, and the Morrill act of 1890. Beyond question the feeling had grown up that equal grants to every state were unsatisfactory, and that the federal government, when it made grants for a service, had the right and the duty of exercising a greater control over performance. This desire for more effective federal supervision was responsible for

[28] Notably in Arizona in 1926, in Rhode Island in 1928, in Mississippi in 1930.

the inauguration of the device of advance federal approval of plans of work. During the hearings on the bill, several people pointed out that to exercise supervision of grants merely by a post-audit was inadequate. As a supplement, submission of plans in advance was required, thus introducing "a principle of basic importance in federal-aid administration." [29]

A good beginning at extension work had been made even before 1914, but thereafter, under the stimulus of grants and still more because of the impact of the war, there was a remarkable expansion. (See Table 7.) Beginning in 1918 the grants of the

TABLE 7

EXPENDITURE FOR COÖPERATIVE EXTENSION WORK IN THE STATES AND TERRITORIES

(thousands of dollars)

Fiscal year	Federal funds	State and local funds	Total
1915	$ 1,486	$ 2,111	$ 3,597
1920	5,891	8,767	14,658
1930	8,733	15,533	24,266
1935	8,945	11,496	20,441
1940	18,530	14,522	33,052
1941	18,591	14,603	33,194

Smith-Lever act were supplemented in varying amounts because the extension agents, in addition to tasks foreseen in 1914, were called upon to assume a number of duties associated with war production or war control. But in the post-war period interest in extension work slackened, provision of state and local funds diminished, and it became evident that, without additional federal assistance, a number of rural counties would have to get along without an agricultural agent and a home demonstration agent. This the agricultural societies were not prepared to tolerate. Pressure was put upon Congress, and in 1928 the Capper-Ketcham act was passed providing an annual authorization of $1,480,000 supplementary to the Smith-Lever grants. Each state (and Hawaii) was to have $20,000, together with a share of the remaining $500,000 proportionate to its rural population. Matching of the flat grant was not required.

[29] Key, *Administration of Federal Grants*, p. 51.

With the onset of depression after 1929 the extension service ran into new difficulties. The amount of state-local funds fell from $15,533,000 in 1930 to $11,496,000 in 1935. The total of the federal funds in 1935 was $8,945,000, and it might seem that, despite the shrinkage in state–local funds, there would be no danger of a loss of federal grants. But these totals once again hide the variations among the states. The flat grants of the Smith-Lever and Capper-Ketcham acts did not have to be matched, and in many states full advantage was taken of this provision. In 1933, for example, in twenty-four states the amount of expenditure from state–local funds was less than the expenditure from federal funds, and therefore a shrinkage in state–local funds did cause the federal requirements of matching to pinch.[30]

The fiscal difficulties of the states and localities naturally brought pressure for larger federal grants, and the Bankhead-Jones act of 1935 provided larger sums for the extension service as well as for the experiment stations and resident instruction. Each state (and Hawaii) was given an additional annual grant of $20,000, plus its share of a sum equal to $8,000,000 in 1936 and growing to a maximum of $12,000,000 in 1939–40. This share was to be based upon farm, rather than rural, population. The census definition made a community "rural" if its population was less than 2,500, and this meant that "many mining camps of Nevada and Pennsylvania have been classed as rural, while more than one New England 'town,' embracing a whole township, has been listed as urban."[31] A change in the basis of allotment was therefore desirable; but farm population is not quite satisfactory, for many aspects of the work of the extension service—home economics, gardening, club work with boys and girls, etc.—is done with people who live in villages and towns, i.e., who are rural non-farm. It would, however, be unrealistic to press very far the relative merits of any of the alternative bases of allotment, because this would be to overlook the fact that the Department of Agriculture carries on a considerable amount of extension work directly; and it may well be—although an analysis has not been

[30] Much of the difficulty would have been avoided by a more generous assumption of costs by state (as distinct from local) governments.

[31] A. F. Macdonald, *Federal Aid* (New York, 1928), p. 55; Works and Morgan, *The Land-Grant Colleges*, pp. 62–63.

made—that this direct expenditure is distributed so as to correct inequities in the expenditure covered by grants.

The grants for the extension service provided by the Bankhead-Jones act departed from precedent in still another particular, since matching of them was not required. This is the more surprising because, as will be remembered, the new grants provided by the Bankhead-Jones act for experiment stations had reversed the practice of the Hatch and Adams and Purnell acts by *requiring* matching. Behind the waiving of matching of the new grants for the extension service was the plain fact that many states and localities were curtailing their expenditure and that the mere offer of new federal grants which had to be matched would not be attractive to them. Congress, assuming without question that curtailment was undesirable, proceeded to offer grants which did not have to be matched, and the effect was to jump the federal share of total coöperative expenditure on the extension service from 45 per cent in the fiscal year 1935 to 56 per cent in 1941.

Behind this willingness of Congress not merely to increase the grants for the extension service, but also to assume a larger relative share of the expenditure, lay one other important circumstance. When the agricultural adjustment program came into operation, the employees of the extension service were called upon to handle many phases of its administration. Indeed, the service had to be expanded appreciably, the costs being borne by the Agricultural Adjustment Administration.[32] There was, however, uncertainty about the continuance of these special allotments, and if the readjustment program for agriculture was to use the extension service, it was obviously desirable that the regular grants be increased. Thus a substantial part—say $5,500,000—of the additional grants provided for the extension service by the Bankhead-Jones act were necessary to carry the expansion caused by the A.A.A. This same step brought also a shift in the program of the extension service, since it was given, in addition to its educational work, a task of regulation. A keen debate has been waged as to the compatibility—not to say the wisdom—of this dualism in function. One group, aware that the service is spread over the nation and in close touch with the farmers, argues that use of the service for purposes of administration will insure

[32] In 1935, $5,583,000 of the A.A.A. funds were alloted to the state extension services.

the effectiveness of the agricultural program; another group declares that the extension service "should hold closely to its educational ideal and avoid performing regulatory functions."[33] The answer lies in the future, but for the present the service is committed to performance of the two functions.

From the brief account given above it will be appreciated that at present the grants for extension work[34] come from a number of different sources and that there is some diversity in the basis of distribution and in the matching requirements. Moreover, the different acts have differed in details as to the specific purposes for which the grants may be spent, and this has caused some awkwardness and confusion in administration. "For example, the Smith-Lever act definitely forbids the use of funds appropriated under the act for promotion of agricultural trains; the Capper-Ketcham act specifically states that the restriction on the use of funds for promotion of agricultural trains does not apply to the additional sums appropriated under its provisions."[35] This sort of confusion has arisen because the program has grown like a patchwork quilt.

There has, besides, been a lack of coördination between these grants and those for related purposes. Friction between extension workers and teachers of vocational agriculture is of long standing, despite attempts to delimit the jurisdiction of each.

[33] Works and Morgan, *The Land-Grant Colleges*, p. 82. "Those who believe that the extension services should confine themselves to educational work argue that in order for an extension worker, for example a county agricultural agent, to do effective agricultural work, he must be welcomed and respected wherever he goes—and that if he goes to a man's farm to enforce some Federal or State regulation, he is not likely to be welcome. He may be suspected of favoritism and, gradually, enough opposition will develop to discredit the agent and finally the entire extension system."

[34] Summary of allotments of federal funds for extension work in agriculture and home economics, fiscal year ending June 30, 1941:

Smith-Lever and Bankhead-Jones acts	$16,805,000
Capper-Ketcham act	1,490,000
Supplementary and additional	237,000
Clarke-McNary act	59,000
TOTAL	$18,590,000

For a discussion of the Clarke-McNary act and of the supplementary and additional grants see Works and Morgan, *The Land-Grant Colleges*, pp. 57–58.

[35] Works and Morgan, *op. cit.*, p. 64.

Thus in work done with boys and girls, the 4-H clubs of the extension service have looked with extreme disfavor upon the Future Farmers of America, formed in connection with vocational education; in adult education in rural areas there has been similar, though less acute, overlapping and competition.[36] The Advisory Committee on Education noticed these conflicts and it felt that the two services, in place of attempting to separate and delimit their respective spheres, should try to coöperate in providing a more comprehensive program.[37] While this may, perhaps, be idealistic counsel, it offers the best long-run prospect of success.

Another instance of how one program infringes on another was provided immediately after passage of the Smith-Lever act in 1914. This act, since it contained a matching requirement, induced the states and localities to expand their expenditures for extension work. But the stimulus in this direction was secured by a curtailment of their expenditure for experiment stations, since this did not have to be matched.[38] Not until 1918 did the state and local expenditures for experiment stations attain the 1914 figure, and here again is an illustration of how Congress, by stimulating one type of state–local activity, may inadvertently injure another.

Vocational Education

Beginning with the first Morrill act, the federal government had shown a special interest in vocational education above the high-school level. The Smith-Hughes act of 1917, providing grants to the states in aid of vocational education in schools of less than college grade, was a manifestation of this "practical" interest in the education of boys and girls who did not intend to go to college and of adult workers who needed instruction not provided by agriculture and industry. It was felt that the regular system of high-school education was deficient in its instruction of this group of young people, and that agriculture and industry also were neglecting to provide apprentice training.

The annual grants of the Smith-Hughes act were for three broad purposes: (1) to aid in paying salaries of teachers of voca-

[36] John Dale Russell and associates, *Vocational Education* (Staff Study No. 8 prepared for the Advisory Committee on Education, Washington, 1939), pp. 146–51.

[37] *Report of the Advisory Committee on Education*, p. 149.

[38] Works and Morgan, *The Land-Grant Colleges*, pp. 38–43.

tional education in agriculture ($3,000,000), (2) to aid in paying the salaries of teachers of vocational training in trades and industries, including home economics ($3,000,000), (3) to aid in teacher training ($1,000,000). Allocation among the states of the grants for vocational education in agriculture was to be according to rural population, that for vocational education in trades and industries according to urban population, and that for teacher training according to population. It was, however, realized that a certain minimum sum was necessary before a state could provide any program, and that, under this scheme, the less populous states would not receive grants adequate for this purpose. The act, therefore, declared that if, on the basis specified, the allotment of a state did not reach $10,000 for each of the three fields of training, additional appropriations to bring it up to the minimum would be made.[39] This modification—followed in later acts—favored the less populous states.

The basic Smith-Hughes act has been supplemented and expanded by later legislation. In 1929 the George-Reed act authorized additional appropriations of $2,500,000 a year[40] for five years, 1930–1934; and in 1934 the George-Ellzey act raised this figure to $3,000,000 for three years, 1935–1937, dividing it equally among vocational education in agriculture, in trades and industries, and in home economics. Moreover, the basis of the allotment was altered so that instead of being (1) rural population, (2) urban population, and (3) population, it became (1) farm population, (2) non-farm population and rural population, and (3) population. Finally, in 1936, the George-Deen act put the authorization on a permanent basis and raised it to $21,785,000, thus more than doubling the existing grants,[41] and it also added the distributive occupations to the categories for which vocational training was to be provided. The 1940 annual authorization was as shown in Table 8. In this supplementary legisla-

[39] The additional sums authorized were $27,000 for agriculture, $50,000 for trades and industries, and $90,000 for teacher training, and they raised the total authorization to $7,167,000. Moreover, this represented the final and maximum authorization which was to become effective by 1926. The authorization for the first year was to be $1,660,000, with a gradual increase to the maximum.

[40] The addition began at $500,000 a year and rose to $2,500,000 by steps. The Smith-Hughes act had, meanwhile, been extended to the territories.

[41] The Smith-Hughes act provided $7,167,000 plus $30,000 for Hawaii (added in 1924) and $105,000 for Puerto Rico (added in 1931). The George-Ellzey act provided $3,000,000.

TABLE 8

ANNUAL AUTHORIZATION, 1940, FOR VOCATIONAL EDUCATION [a]
(thousands of dollars)

	Smith-Hughes Act	George-Deen Act	Total
Agriculture	3,018 (rural population)	4,067 (farm population)	7,085
Trade and industry, and home economics	3,042 (urban population)	4,059 (non-farm population)	11,150
		4,049	
Distributive occupations		1,254 (population)	1,254
Teacher training	1,090 (population)	1,054 (population)	2,144
Total	7,150	14,483	21,633

[a] U.S., 77th Congress, 2nd session, House Committee on Appropriations, Hearings, Federal Security Agency Appropriation Bill for 1943, pp. 286–87.

tion the minimum allotment per program for each state was increased so that in 1934, instead of $10,000 it became $15,000, and in 1936 it became $20,000 for agriculture, home economics, trade and industry, and $10,000 for distributive occupations and teacher training. This meant that the minimum total of federal allotments to a state for vocational education was $110,000.[42]

The generosity of Congress toward vocational education in 1936 occasioned a good deal of surprise and encountered some opposition. President Roosevelt signed the George-Deen act (June 8, 1936) with reluctance and he requested that, before the additional authorization be put into effect, an investigation of federal aid to vocational education be made.[43] Congress, however, refused to follow his advice, yielding instead to a very

[42] The special allotments necessary to provide the less populous states with this minimum are greatly in excess of the allotments on the regular basis, as the following examples show:

Allotments for vocational education, 1939–40, in thousands of dollars:

	Regular	Special	Total
Nevada	16.1	93.9	110.0
Delaware	39.9	70.1	110.0
Wyoming	44.0	66.0	110.0

U.S., 76th Congress, 1st session, House Committee on Appropriations, Hearings on the Interior Department Appropriation Bill, 1940, pp. 886–90.

[43] He himself in September 1936 appointed a committee to make a review, and the duties of this committee were later broadened to include investigation of the relation of the federal government to the whole field of education.

active lobby directed by the American Vocational Association which, according to Senator Byrnes, did "the most thorough job since the days when we received telegrams to oppose the utility holding company bill." [44]

All of the acts providing federal grants for vocational education, until the George-Deen act, required state–local matching, but in fact the states and localities have gone much beyond this, although with unequal generosity toward the different categories. As Table 9 shows, home economics and trade and industry have been favored over agriculture and teacher training. In part this

TABLE 9

STATE AND LOCAL EXPENDITURE FOR VOCATIONAL EDUCATION PER $1.00 OF FEDERAL EXPENDITURE, FISCAL YEAR 1936 AND 1942[a]

	1936	1942
Agriculture	$1.67	$1.66
Trade and industry	3.38	2.27
Home economics	3.06	2.03
Teacher training	1.22	1.19
Distributive education	...	.70
Total	2.43	1.84

[a] Russell, *Vocational Education*, p. 85; Digest of Annual Report of State Boards for Vocational Education to the U.S. Office of Education, fiscal year 1942, p. 5. In recent years state expenditure has been about one-third of local, and it is growing at a faster rate than local.

situation is to be explained by the fact that the states interested in industrial and home-economics training are the richer states, while those interested in agricultural training are the poorer.[45] But part of the explanation is also the relative public interest in the different programs.

Here as elsewhere an over-all comparison of federal with state–local expenditures hides interstate variation. While in 1942 the expenditure of $1.00 of federal money was accomplished by expenditure of $1.84 by the states and localities as a whole, in some states there was little overmatching.[46]

[44] Russell, *Vocational Education*, p. 23.

[45] Within states the same factor is at work, since in agricultural states the rural localities in which agricultural education is appropriate have little fiscal ability.

[46] In 1941–42 the state and local expenditures of eleven states under the George-Deen act did not equal federal expenditure. In a few states, however, the state-

The George-Deen act specified that, except for teacher training, the new federal grants did not have to be fully matched. From 1936 to 1942 the states and localities needed to put up only fifty cents for each federal dollar; after 1942 the state–local contribution must increase 10 per cent each year until full matching is provided. It is, of course, obvious that even after 1942 the alteration required no extra expenditure in those states which have greatly overmatched the federal expenditures. To them the new grants are windfalls. But states which in 1936 were barely matching the federal expenditures were, after 1942, pushed into further commitments. Since this latter group includes a good many of the poorer states, the result may be unfortunate.

The federal statutes dealing with vocational education are perhaps more specific and detailed than any other grant legislation. Fields of vocational education are singled out and a definite amount of aid is set for each. "The proportion of the pupils' time to be devoted to vocational subjects is specifically stated. Directed or supervised practice is required and the number of months which the school course and the practical course shall continue are specified. The number of hours per week to be devoted to vocational subjects by the pupils in full-time schools, and the number of hours per year for part-time pupils are definitely stipulated."[47] In the federal administration of the legislation this specificity has been extended and amplified. Behind this lay understandable reasons. Education is a field in which the federal government must tread with care, and therefore it seemed wise to define the limits of its activity both by legislation and by regulation. Yet definition of fields which are vague in scope and changing in content is very difficult. Again, the activities being subsidized are, for the most part, run by *local* governments. How is the federal government to supervise them? Nat-

local expenditure was greatly in excess of federal expenditure, as the following table shows:

	Federal	State and local
	(in millions of dollars)	
Indiana	351	938
New Jersey	269	1,277
New York	896	2,355
Pennsylvania	841	1,941
Texas	780	1,956

[47] Russell, *Vocational Education*, pp. 38–39.

urally the effort of the federal administration has been to push this task upon state officers.[48]

At no time has the federal effort escaped criticism from the most divergent quarters. Its standards for state administrative personnel and for teachers have been said to be both too high and too low; and those for teachers of industrial education have, besides, faced objections from labor, industry, and professional educators. The federal authorities have favored using teachers with actual experience in industry, even if they did not meet the educational qualifications set up by state laws. Yet both industry and labor have complained that the training is not adequate, and labor has insisted that vocational education has engendered "anti-union" habits of thought and that students have been "enrolled in trade classes without sufficient consideration of replacement needs." [49] The educators have insisted that federal aid "promoted a cleavage in the system of public education," and "increased the difficulties of management in the local school system." [50] It is impossible to catalogue here all the criticisms which have been made, but what should be noticed is that some of these criticisms are mutually inconsistent. If the federal control has been excessive, how did it happen that in certain states plant-training programs were turned into schemes for providing firms with cheap labor? [51] It may well be that the program as set up has not provided for local variation and experimentation, but it is also certain that, within its boundaries, there have been practices in certain states which cannot be condoned in a national scheme. The bureaucratic rules have been the result of a lack of real federal power and of an inability to exercise adequate supervision. To suggest that the rules alone explain the defects

[48] The Federal Board of Vocational Education, the original supervisory agency, was at first an independent board consisting of the secretaries of Agriculture, Commerce, and Labor, the United States commissioner of education, and three members representative of agriculture, manufacturing, and labor. It was continually under fire, and in June 1933 President Roosevelt transferred its functions to the Department of the Interior and reduced the Board to an advisory capacity. Since 1933 it has been inactive, and the United States commissioner of education has been the principal administrative officer. The Office of Education was shifted to the Federal Security Agency in 1939.

[49] Russell, *Vocational Education*, p. 287. And see Appendix A, by H. H. Broach and J. O. Parker, "The Experience of Labor with Trade and Industrial Education," *passim*.

[50] Russell, *Vocational Education*, pp. 75, 130.

[51] See Key, *Administration of Federal Grants*, pp. 98–99.

of the program is to mistake the occasion for the cause.[52] If federal dictation were possible, multiplicity of rules would be unnecessary.

There is another criticism which has much weight and which brings out a defect inherent in any piecemeal scheme of conditional grants. It is that the stimulus given to state–local expenditure for vocational education has taken funds which otherwise would have gone to general education. The inadequate program of general education of many states can, therefore, be blamed in part on the grants for vocational education. When in 1917 the federal government entered the field, it was widely believed that provision for vocational education had lagged and that a special stimulus was necessary in the national interest. Federal grants were designed to provide the stimulus and also "to purchase a degree of participation in the work." [53] But stimulus as a purpose of grants in aid implies a temporary situation; [54] and yet here, as elsewhere, the federal participation, instead of being tapered off, was expanded. Some enthusiasts would declare that the need for stimulus remains, but before this is conceded it should be noticed that, while some states can stand further stimulus, others cannot. A rich state, with a high level of provision for all governmental services, has no difficulty in responding to federal grants for a particular service, and the possible distortion which this may bring into its total fiscal plan is not serious. A poor state, however, can often expand one line of activity only by sacrificing others, and this Congress is likely to overlook. What should be considered by Congress, after a program has been well launched, is, first, whether or not it merits continued federal support. If the answer is affirmative, then the next question should be how this support can be given so as to equalize—or at least so as not to distort—the burden upon the various states.

If these questions had been considered, the George-Deen act of 1936 would never have been passed. The vocational-education grants are not framed on an equalizing basis. Farm population, non-farm population, and total population are only very rough measures of needs for particular types of vocational edu-

[52] A good deal of the criticism in Russell, *op. cit.*, comes perilously close to doing just this.

[53] Federal Board of Vocational Education, *Bulletin No. 1: Statement of Policies* (Washington, 1917), p. 7.

[54] Russell, *Vocational Education*, p. 225.

cation;[55] and expansion of the grants, together with the matching basis, has pushed poorer states into a disproportionate expansion of this type of expenditure.

The Advisory Committee on Education, in the report which it made to President Roosevelt in 1938, was severely critical of the federal program of vocational education. "The general operation of the various programs of vocational education has," it declared, "been exceedingly unsatisfactory in a number of respects. A few of the major points of adverse general criticism are as follows: (1) The difficulties in administering local schools have been increased; (2) there has been some tendency toward the creation of a dual school system; (3) arrangements for coördination with the interests served by other Federal agencies, particularly the Departments of Agriculture and Labor, have been inadequate; (4) relatively little research of an evaluative type has been carried on; (5) Negro schools in most States that maintain separate school systems for Negroes have not been justly treated. These criticisms apply more to some of the programs than to others, but the deficiencies enumerated have been chronic throughout the federally aided system of vocational education."[56] The recommendations of the committee for reform are, however, far from convincing. Revision of the federal vocational education acts so as to remove the excessive specificity of federal conditions and to leave to the states "the determination of the educational activities to be deemed vocational"[57] strikes at defects which now lie on the surface. It overlooks the clear danger that in certain states—those most in need of guidance and direction—the slackening of federal conditions will lead to expenditure of federal funds for purposes which have no place in a national program, and of which Congress would be ashamed. The plain truth is that if bureaucratic controls are to be slackened, other controls need to be substituted, and these Congress has been unwilling to provide. One can talk vaguely of federal guidance rather than federal coercion, of the need of coöperation among all levels of government in a common program. These are aspirations only, and the road to their achievement is rough. Progress will be more certain if sufficient federal conditions are imposed to hold backward states

[55] See Russell, pp. 98–110 for criticism.
[56] *Report*, p. 80.
[57] *Report*, p. 81.

to a minimum level of provision of the service, and if federal administrative officers have the power and the courage to penalize non-performance.

The Advisory Committee was concerned also about the distortion to the educational program of the nation which aid to vocational education brought. Here its remedy, as will be seen later, was not curtailment of the existing grants, but inauguration of new grants covering the fields of education which have been neglected by the federal government. In this way a parity would be reestablished by lifting up the provision of elementary and secondary education to a higher level, and then, at some later date, consolidating all the federal aids to education.[58] Obviously this answer lies in the future, and it raises very many controversial issues which so far Congress has not been willing to face.[59]

One must then conclude that the federal efforts in the field of vocational education have not been altogether fortunate. Professional educators, industrialists, labor men have offered criticisms which, while often inconsistent, are certainly sincere. The very inconsistency of the criticisms indicates the difficulties of federal–state coöperation in the field of education. An educational program arouses the interest of most citizens, but about its content and nature there will inevitably be serious disagreement.[60]

Vocational Rehabilitation

A governmental program for vocational rehabilitation involves assistance to disabled persons to fit them for employment, and it is only in part a problem of education. Indeed, it arose in the United States as an addition to workmen's compensation because of clear evidence that the money benefits of this compensation were often inadequate to provide support and usually inadequate to enable a disabled worker to provide for his own rehabilitation in a new vocation.

A few states recognized the importance of retraining workers

[58] *Report*, p. 83.

[59] In 1939 a bill was introduced by Senator George which aimed at revision of the vocational-education acts so as to lessen federal supervision (*Congressional Record*, vol. 84, p. 5773), but it made no progress.

[60] In 1940 Congress provided for federal payments to the states for vocational training in occupations essential to national defense. The entire cost of instruction was to be borne by the federal government. The expenditure in this war-production training program for the fiscal year 1942 was $89,485,000.

before there was any federal program,[61] but general public interest was first aroused as a result of the efforts made by the federal government after 1918 to rehabilitate and return to private employment its disabled veterans. Bills were introduced into Congress to provide federal aid for rehabilitation of civilians, and in 1920 legislation was enacted which has since been revised and extended. The original legislation provided $1,000,000 a year to be apportioned among the states according to population, with the requirement of matching from state and local funds; [62] the social security act in 1935 raised this to $1,938,000 and its amendment in 1939 to $3,500,000. The minimum allotment to a state was set at $5,000 in 1920 and at $10,000 in 1930. The states accepted the scheme fairly promptly; by 1929 all but four participated and by 1939 these four had come in.[63]

TABLE 10

FEDERAL AND STATE AND LOCAL EXPENDITURES FOR VOCATIONAL REHABILITATION[a]

(thousands of dollars)

Fiscal year	Federal	State and local	Total
1921	93	191	285
1931	933	1,110	2,043
1935	1,032	1,216	2,248
1940	1,972	2,136	4,108
1942	2,557	2,648	5,204

[a] A small amount of relief funds was spent in 1933–1937 for vocational rehabilitation. See Blauch, *Vocational Rehabilitation*, pp. 8–9.

It will be seen from Table 10, however, that the annual federal authorizations have not been spent. Until the 1930's one-third to one-half of the federal allotments (of $1,000,000) were not taken up. Thereafter the program expanded more rapidly, but in only a few states—New York, Wisconsin, and Montana—have the federal grants been overmatched by more than small

[61] Twelve states had enacted vocational-rehabilitation laws by June 1920, Massachusetts being the first to act in 1918.

[62] Expenditure of a private agency may be counted toward matching under restricted circumstances. L. E. Blauch, *Vocational Rehabilitation of the Physically Disabled* (Staff Study No. 9, prepared for the Advisory Committee on Education, Washington, 1938), p. 35.

[63] Kansas, while it accepted the legislation, made no appropriation and therefore received no grant in 1939. In 1939 Delaware accepted the legislation.

sums. The number of persons rehabilitated rose from 5,184 in 1931 to 10,747 in 1939 and to 11,890 in 1940; but "it is estimated that only 20% of the persons who are disabled annually in the United States and who are eligible for and feasible of vocational rehabilitation for usual types of employment are receiving help." [64]

Administration of the vocational-rehabilitation act was placed in the hands of the Federal Board for Vocational Education until 1933, when the Board was reduced to an advisory capacity and the Office of Education took over its duties. The original administrative choice in 1920—together with the parallel requirement that the state board of vocational education be the state administrator—is defensible on the ground that there was no better place to put the new service. Since then, however, the welfare activities of the federal government and of the states have expanded enormously, and it has been argued that some one of the newer agencies is better equipped to handle the job. Certain it is that federal administration of vocational rehabilitation has not been satisfactory whether because—as is alleged—educational activities have dominated the work of the Board for Vocational Education and the Office of Education, or—as is more plausible—because of lack of strong state–local interest in the service. When in 1939 the new Federal Security Agency was created, the Office of Education was placed in it and one may hope that improved administration will follow.

At present a great expansion of vocational rehabilitation is in process because of the increase in 1939 of the federal grants. Few programs offer the prospect of clearer social gains. Some 60,000 persons annually in the United States are disabled who can, through rehabilitation, be returned to regular lines of competitive employment, while 150,000 more can be returned to sheltered employment.[65] Since rehabilitation of the former group costs approximately $300 per person, while maintenance of a disabled person in idleness costs society—government or individuals—approximately $500 a year, there is a clear advantage in expanding the services to cover 60,000 rather than the 11,000 per-

[64] Blauch, *Vocational Rehabilitation,* p. 42; also *Report of the Advisory Committee on Education,* p. 158.

[65] An additional 50,000 persons are so disabled as to be able at best only to work in their homes. U.S., 76th Congress, 1st session, Senate Report No. 734: *Social Security Act Amendments of 1939,* p. 38.

sons now rehabilitated. On humanitarian grounds there are, besides, strong reasons for attempting to bring the disabled back toward a normal existence.

Direct Federal Expenditure for Education

In addition to its expenditure on education by grants, the federal government has also certain direct educational responsibilities. The most important of these for 1937–38 are shown below:

Office of Indian Affairs	$10,049,000
United States Military Academy	3,121,000
United States Naval Academy	2,023,000
Public Schools, District of Columbia	1,591,000
Office of Education	889,000
Howard University	700,000
Public Schools—Panama Zone	455,000
National Training School for Boys	248,000
Columbia Institute for the Deaf	145,000

About these only the briefest comment need be made. The largest sum, that spent by the Office of Indian Affairs, occurs because for many years the Indian has been regarded as a ward of the federal government. Despite good intentions, the results have not always been happy, and as recently as 1931 the National Advisory Committee on Education of President Hoover condemned the past program and made recommendations for reform which had as their main purpose that instruction should be related to the needs and interests of the Indians, with particular emphasis on vocational and agricultural education and with avoidance of an attempt at "Americanization."

The Office of Education dates from 1867, and its chief task for many years was to collect educational statistics. Gradually new duties were given to it, particularly in connection with federal grants for education, but many people were fearful of federal intrusion and it long remained "a minor bureau in an executive department [the Department of the Interior] whose major interests have been foreign to education."[66] Since 1933, however, the Office has been more active, and if, in the future, there is to be an expanded program of federal aid for education, it is bound to be the administrative agency and it will need to be strengthened in personnel and equipment.

[66] Report of the Advisory Committee on Education, p. 180.

Emergency Expenditures on Education

After 1933 the federal government made expenditures for education on an emergency basis which amounted to appreciable sums. The Civilian Conservation Corps was established in April 1933, primarily as a method of work relief, but it later built up an educational program. The Federal Emergency Relief Administration in 1934 began a system of student aid which was continued by the National Youth Administration. On this program, designed to give financial assistance to students who otherwise could not continue their schooling, $24,000,000 was spent in 1935–36, $28,000,000 in 1936–37 and $19,091,000 in 1937–38.[67] Of these sums approximately 40 per cent has gone to students in elementary and high schools, 56 per cent to undergraduates in colleges, and 4 per cent to graduate students.

Many of the WPA programs infringed upon the field of education. Indeed, the Division of Education projects of WPA had activities so protean that no attempt can be made to describe them here. The field of education, particularly of adult education, offered great opportunities for work relief because little equipment was required and because teachers with a desire to teach and learners with deficiencies in their education were numerous. Few types of projects allowed so much improvisation with some prospect of achievement. There was, besides, the job of keeping in operation those educational facilities which localities, hard hit by depression, were inclined to close up. Many communities were permitted to maintain their schools by employing teachers on the relief rolls. Of a similar nature was the job of constructing and repairing educational buildings over the nation. WPA, and to a less degree PWA, built libraries, schoolhouses, recreational buildings, and playgrounds on a vast scale. The National Advisory Committee on Education summed up these activities as follows: "Federal work relief funds administered by this agency [WPA] and its predecessor organizations have been spent to the extent of more than $250,000,000 for the repair of old and the construction of new buildings for educational and community recreational activi-

[67] Palmer O. Johnson and Oswald L. Harvey, *The National Youth Administration* (Staff Study No. 13 prepared for the Advisory Committee on Education, Washington, 1939), p. 17; also *Federal Funds for Education, 1937–38,* p. 15. These figures do not include expenditure on the work projects of N.Y.A.

ties. An emergency education program employing as many as 44,000 unemployed teachers has offered instruction to enrollments in excess of 1,725,000. A large program of non-commercial recreational service has been provided. Books and other school equipment have been repaired, libraries have been maintained, school lunches have been provided, and numerous other useful activities have been carried on in connection with the educational system." [68] In addition PWA up to the end of 1937, had "authorized grants totalling $263,000,000 for the construction and repair of educational buildings, supplemented by loans to the amount of $83,000,000." [69] Recently the emergency educational activities of the federal government were first sharply curtailed and then cut off. But behind this sudden burst of federal expenditures lie needs which have long been felt and which, in the opinion of many people, can only be satisfied through some form of regular and enlarged federal aid.

The Recent Agitation for Federal Aid

During the depression the relative share of educational expenditure in the United States borne by the federal government grew appreciably. But in 1938, despite the presence of emergency items which have since diminished, it was only 8.2 per cent of the total. State governments also have assumed a larger relative and absolute burden of educational expenditure, yet it was still true that the educational system was predominantly local.

TABLE 11

Government Expenditure for Education [a]

	1932	1938 (*millions of dollars*)	1941	1932	1938 (*per cent*)	1941
Federal......	47	201	165	2.1	8.2	6.4
State........	542	818	909	25.4	33.6	36.0
Local........	1,549	1,418	1,474	72.5	58.2	57.6
	2,138	2,437	2,547	100.0	100.0	100.0

[a] Taken from Clarence Heer, *Federal Aid and the Tax Problem* (Staff Study No. 4 prepared for the Advisory Committee on Education, Washington, 1939), p. 21; *Bulletin of the Treasury Department*, August 1939, p. 4; 78th Congress, 1st session, Senate Document No. 69: *Federal, State and Local Government Fiscal Relations*, p. 356. To the figures for 1938 I have added the federal grants for agricultural extension and experiment stations.

[68] *Report*, p. 37.

[69] *Ibid.*, pp. 36–37.

Approximately 127,000 school districts have an important measure of autonomy about the type and the quality of education to be offered, and they have also heavy responsibilities for its finance. Inevitably this has meant unequal burdens and uneven provision of facilities; and although many state governments have endeavored to diminish these inequalities by providing grants for the assistance of the poorer districts, these equalization funds have generally been inadequate in amount and defective in the method of their distribution. And there are, besides, great differences among the state governments themselves in financial ability which preclude uniformity in the provision of educational services no matter how effective the method of equalization *within* states.

Let us consider first the disparities among states in the actual provision of education, and then the disparities in their ability to support it. The current expenditure in 1937–38, per pupil in average daily attendance at public elementary and secondary schools, varied from $24.55 in Arkansas to $147.65 in New York,[70] and for six states the figure was less than $40.00. A similar disparity is shown by teachers' salaries—the largest single item of educational expense—which ranged in 1935–36 from an average of $2,414 in New York to $504 in Arkansas.[71] Additional evidence could be cited, but there is no need to labor the obvious fact that the provision of public education—as shown by expenditure—differs greatly in the different states.

TABLE 12

CURRENT EXPENDITURES PER PUPIL IN AVERAGE DAILY ATTENDANCE IN THE VARIOUS STATES, 1935–36 AND 1937–38

	Number of states 1935–36	1937–38
$ 20.00– 39.99	9	6
40.00– 59.99	6	5
60.00– 79.99	14	14
80.00– 99.99	12	12
100.00–119.99	5	7
120.00–139.99	2	4

70 Report of the Advisory Committee on Education, p. 225; U.S., 76th Congress, 1st session, Senate Committee on Education and Labor, Hearings, Educational Finance Act of 1941, pp. 107–08.

71 The difference cannot be explained in terms of urban–rural areas, as a breakdown into salaries paid by states in urban and in rural schools discloses. See U.S., 76th Congress, 1st session, Senate Committee on Education and Labor, Hearings, Federal Aid to Education Act of 1939 (S. 1305), pp. 38–39.

In measuring disparities in the ability of the states to support education, the most common method has been to calculate the amount of revenue which each of the states could raise for educational purposes through use of a standardized tax plan.[72] Suppose the states, by levying a given set of taxes at uniform rates, raised enough revenue *on the average* to cover current expenditure *on the average* in 1935–36, what would the relationship be for each state between hypothetical revenue and actual expenditure? These two sets of figures, when divided by the number of children in each state, may be said to show the revenue available per child when each state makes an equal tax effort, and the current expenditure per child. A comparison of the states at the bottom and top of the list is given in Table 13. The evidence

TABLE 13

REVENUE PER CHILD FROM A UNIFORM TAX PLAN, AND CURRENT EXPENDITURE PER CHILD, 1935–36, FOR FIVE TOP-RANKING AND BOTTOM-RANKING STATES[a]

	Year 1935–36 Revenue per child from a uniform tax plan	Current expenditure per child
Delaware	$147.85	$ 68.60
Nevada	129.69	109.87
New York	125.66	95.08
California	91.15	97.07
Average	51.77	51.77
Arkansas	15.20	15.81
Alabama	13.38	18.61
South Carolina	13.30	19.80
Mississippi	12.21	20.13

[a] *Report of the Advisory Committee on Education*, p. 226.

is that the poorer states are making a relatively greater effort to support education than are the richer states. In the richer states the actual expenditure is found to be less than the revenue which could be raised by this tax effort; in the poorer states the actual expenditure is greater than the revenue which could be raised by a similar effort. The failure, therefore, of the poorer states to

[72] This is a modified form of the model tax plan of the National Tax Association. A more exact description will be given later.

provide an adequate expenditure per child is attributable to a defect of fiscal resources.

Of what significance is it that 60 per cent of the children in the United States live in states which cannot be expected to provide an expenditure of $50 per child? Education is preparation for citizenship, and an adequate education is, therefore, the right of every child. Moreover, the richer states and the urban areas have another and more particular reason to be concerned about provision of proper education over the nation. In the United States there has always been a large internal migration of population by which the industrial states, and especially the cities, have recruited their workers from the rural communities—that is, from areas where educational facilities are often inadequate.

It is by arguments such as these that federal intervention in the field of general education has been advocated for many years. There is a national interest in education, and therefore the federal government should carry part of the cost. How is its share of the cost to be measured? Most of the proposals take as a premise the proposition that there is a national minimum level of educational provision below which the actual provision ought not to fall. If certain communities cannot, by reasonable effort, themselves provide this minimum, then federal intervention is indicated. And almost all of the schemes favor intervention by grants in aid, because direct federal action would offend some of the strongest of American traditions.

Congressional consideration of federal aid to general education goes back many years. From the 1870's on the National Education Association passed numerous resolutions in support of this policy and numerous bills were introduced into Congress.[73] Measures sponsored by Senator Blair passed the Senate on three successive occasions, 1884–1887, without favorable action by the House. The Blair bills provided for the distribution of federal aid to general education in proportion to illiteracy within the states, and they would, therefore, have provided relatively large grants to the South. The constitutional objection, resting on the tenth amendment, was probably of little weight; but the strong opposition of important and cohesive groups was impressive, and the advocates of federal grants turned toward proposals which

[73] *Report of the National Advisory Committee on Education,* Part II (Washington, 1931), pp. 156–57.

looked to aid for particular types of education. Not until the 1920's did a serious agitation for federal aid to general education come to life once more. Then President Hoover appointed a National Advisory Committee which, despite a manifest apprehension about centralization, was favorable to federal aid to education in general.[74] This opinion received little attention until President Roosevelt appointed an Advisory Committee on Education which reported in 1938.[75] Bills were introduced into the Senate and House which contained the substance of its recommendations, and the Senate bill, after hearings, was recommended for passage by the Committee on Education and Labor. No further progress has been made,[76] but the recommendations of the Advisory Committee deserve close attention.

By the new proposals, additional federal grants, amounting at the outset to $72,000,000 a year and rising after six years to $202,000,000, were to be given for the purposes set forth in Table 14.[77] The most novel feature of the proposed grants for

[74] *Ibid.*, Part I, pp. 38–39. A minority of 8 of the 51 members voted against the adoption of the report as a whole and submitted two dissents.

[75] The committee was first appointed to study the experience with federal aid to vocational education and then was converted into a general Advisory Committee. The occasion for the change was that a bill providing federal aid for education, sponsored by Senators Harrison and Black, had been approved by the Senate Committee on Education and Labor. The president desired fuller information before further action was taken.

[76] U.S., 76th Congress, 1st session, Senate Report No. 244: *Federal Assistance to the States for the Support of Public Education.* The president had earlier announced that "the proposed legislation would not be in accord with his program." U.S., 76th Congress, 1st session, Senate Committee on Education and Labor, Hearings on S. 1305, Federal Aid to Education Act of 1939, p. 23.

[77] The six-year basis was recommended "in the belief that Federal relations to State and local conduct of education should again be reviewed under appropriate auspices before those grants are enlarged or are placed upon a permanent basis" (*Report of the Advisory Committee,* p. 197). The grants in S. 1305 differ in minor details from those of the Committee. The Senate Committee on Education and Labor in 1941 (U.S., 77th Congress, 1st session, Hearings on S. 1313) held hearings on a new bill, S. 1313, which associated the educational problem with national defense and problems of Negro education. Then in 1943 the same Committee reported out a similar bill (U.S., 78th Congress, 1st session, Federal Assistance to the States in more adequately financing public education, Report No. 323). This bill proposed an annual grant of $200,000,000 during the emergency for the purpose of supplementing teachers' salaries. The grant was to be apportioned to all the states according to the number of pupils in daily average attendance. A second portion of the bill proposed an annual grant of $100,000,000 for the purpose of reducing inequalities in educational opportunity. It was to be permanent. The basis of apportionment was to be an "objective formula" of financial need resting upon (a)

TABLE 14

PROPOSED FEDERAL GRANTS FOR EDUCATION[a]

(*millions of dollars*)

	1st year	2nd year	3rd year	4th year	5th year	6th year
General aid to elementary and secondary education	40.0	60.0	80.0	100.0	120.0	140.0
Improved preparation of teachers and other educational personnel	2.0	4.0	6.0	6.0	6.0	6.0
Construction of school buildings to facilitate district reorganization	20.0	30.0	30.0	30.0	30.0	30.0
Administration of state departments of education	1.0	1.5	2.0	2.0	2.0	2.0
Educational services for adults	5.0	10.0	15.0	15.0	15.0	15.0
Library service for rural areas	2.0	4.0	6.0	6.0	6.0	6.0
Coöperative educational research, demonstrations, and planning	2.0	3.0	3.0	3.0	3.0	3.0
Total proposed grants	72.0	112.5	142.0	162.0	182.0	202.0

[a] The existing grants were left nearly unchanged.

elementary and secondary education, preparation of teachers, construction of school buildings, and administration of state departments of education was the plan of allocation. Starting from the premise that what the states needed was aid rather than stimulus, the grants were "to assist in equalizing educational opportunities." This required measurement of the "educational load" and the "financial ability of each state." Educational *load* was taken to be the number of persons aged 5–19 years in a state, with rural persons counting 1.4 times as much as urban on the premise that the cost of educating them was that much greater.[78] The absolute figures of educational load were put in relative form, and the index for Wisconsin, for example, was 2.32 per cent. Financial *ability* was measured by calculating the amount of revenue which each state would raise by a uniform plan of taxa-

the number of persons aged 15 to 17 years in the states, and (b) the financial ability of the states as shown by total estimated income payments. The measure after debate was recommitted on October 20, 1943, by a vote of 53 to 26.

[78] For a discussion of the elements in educational load see Paul R. Mort, Eugene S. Lawler, and associates, *Principles and Methods of Distributing Federal Aid for Education* (Staff Study No. 5 prepared for the Advisory Committee on Education, 1939), pp. 54–69.

tion.[79] These figures also were put in relative form, and the index of financial ability for Wisconsin was 2.05 per cent. A measure of need was secured by relating those two indices by subtraction. For Wisconsin the index of educational load exceeded the index of financial ability, and this difference was presumed to indicate the financial *need* of Wisconsin for a grant. On the other hand, the states for which the index of financial ability exceeded the index of educational load would not be entitled to any grant. It was, however, the opinion of the Advisory Committee that, since the coöperation of these states was desirable in such administrative matters as submission of uniform educational reports, some grant should be made. The Senate bill accordingly provided that, if the well-to-do states agreed to coöperate, they would be credited "with an index of financial need not less than five percent of such state's index of educational load."[80]

It will be apparent even from a simplified summary that this approach to the equalizing grant is cumbersome and complicated. Measurement of financial ability in particular seems unsatisfactory, and, as will be seen later, other proponents of the equalizing grant have favored use of state per capita income as a substitute. To this alternative, supporters of the education bill have objected that the pertinent financial ability should be measured, not in terms of a general ability to pay all taxes, but in terms of a system and technique of taxes which are now available to the states.

Postponing for the present any examination of this issue, let us notice some very practical defects in the approach of the education bill. The uniform tax plan is assumed to be a fair measure, not merely of the financial ability of the states as a whole, but of the ability of each state; and this assumption is unjustified. The tax plan used is based upon the model tax plan endorsed by the National Tax Association. The Association had, however, no thought that the taxes embraced in its model, when levied *at uniform rates,* provided a measure of relative fiscal ability. Moreover, the model plan of the Association included a gasoline

[79] *Ibid.*, p. 49, for a statement of taxes and rates. It should be mentioned that an alternative method of measuring financial needs was specified in S. 1305 by which a number of economic series—wealth, income, retail trade, etc.—were to be combined on an empirical basis into an index.

[80] S. 1305, sec. 14 (b). This abbreviated exposition omits mention of several modifications of the scheme which are of no present importance.

tax and taxation of motor vehicles, which were excluded in the educational calculation on the ground that these were benefit taxes and that a welfare scheme should be financed only by ability taxes.[81] The reasoning is not convincing, and in any case other taxes which are included—real estate taxes, stock transfer tax, severance tax—are at least equally defective. Finally, in the bill as submitted, an alternative method of measuring financial ability is provided which knocks the logical props from under the uniform tax plan. This alternative provides that the Secretary of the Treasury shall at his discretion estimate the financial ability of the states by a composite and empirical formula made up from a number of economic series. During the hearings, illustrative results from an experimental formula were submitted, and these showed certain disturbing differences from the results obtained by the uniform tax basis, although it appears that the aim was to devise a formula which would give similar results. Thus, when the formula is used, the financial ability of Maine and Vermont rises by 47 per cent, that of Illinois by 30 per cent, and that of California by 22 per cent; while that of Virginia, of Mississippi, of Texas, of Utah (to take only examples) declines by 20 per cent, 20 per cent, 18 per cent, and 17 per cent. The data for series which might be included in a formula are, in the main, reliable and objectively determined, but the weights to be given to the various components are a matter of judgment and can always be questioned. Unless there is something wrong with the uniform tax method, an alternative should not be provided; if there is something wrong with it, this particular alternative leaves the whole problem of measuring financial ability unsettled.

Is there a method of measuring financial ability which is more acceptable? The later versions of the educational-aid bills indicate a leaning toward indices based upon state per capita income payments. Whatever form taxes take, they are paid from income, and therefore, it is argued, income provides a measure of the financial ability of a state. Many technical questions concerning such figures are in dispute, but all of them are details which do not seriously impair their inherent merit in providing a foundation upon which to build equalizing grants in aid.[82]

[81] Hearings, Federal Aid to Education Act of 1939, p. 77.

[82] If per capita income payments are used to measure financial ability, the figures of income payments need to be adjusted so as to take account of the distribution of incomes of individuals within a state.

Let us turn back to a description of the proposed grants as set forth in the preceding table. Those for adult education—educational services for adults—were to be alloted among the states according to population over twenty years of age, and they were intended to be a substitute for the program of adult education being carried forward on an emergency basis by WPA and NYA. The grants for rural library service were to be alloted according to rural population, in the hope of securing services for rural areas comparable to those available in urban communities. The grants for coöperative educational research were to be split into two parts, with 60 per cent going to state departments of education, colleges, etc., to carry on research and demonstrations in the field of general education, and 40 per cent going to the Office of Education.[83]

The four remaining grants—for elementary and secondary schools, improved teacher preparation, construction of school buildings, and administration of state departments of education—were all related, and they contained by far the most radical features of the whole scheme.

The purpose of the grants for construction of school buildings was not merely to improve the educational equipment, but also to facilitate district reorganization. While few reforms in the system of public education are more desirable than reorganization or consolidation of school districts, progress in many states has been hampered by the difficulty of securing money to build new school buildings which were appropriate to the reorganized school districts. Here, then, was an obstacle which federal grants might remove. And action of this sort was particularly necessary as a supplement to the proposed grants for the current operation of schools. Grants for current operation might well serve to "perpetuate and entrench unsound district organization unless some definite corrective stimulus is provided."[84] Experience with WPA and PWA had provided a further object lesson. Through them a good deal of federal money had been spent to build or renovate school buildings, and unfortunately some of those were

[83] Hearings, Federal Aid to Education Act, pp. 59–60. Title V of the education bill provided funds for education of children in federal reservations and foreign stations, but since this is not a problem of grants, it will not be discussed here.
[84] *Report of the Advisory Committee*, p. 64.

poorly located to meet present or future needs.[85] WPA and PWA were not concerned with educational planning, and besides, federal suggestions about reorganization of school districts may not be welcomed by local and state officers. Here then was a problem of which the Advisory Committee on Education was well aware. Federal intervention in the field of general education was a delicate matter, and yet, without intervention, federal grants might become a deterrent to structural reorganization. The committee decided that the federal government should give the grants subject to conditions which would require "reorganization of administrative and attendance areas." [86] Unfortunately, these safeguards did not appear in the Senate bill and their omission must be regarded as highly damaging. The main condition which the Senate bill attached to this grant was state–local matching of federal money.

The proposed grants for elementary and secondary education called for a larger expenditure than all the other grants together, and here again only a minimum of federal conditions was to be utilized. Audits and reports were to be required, and if misuse of funds was disclosed, grants might be withheld. Matching was not required, although it was specified that these grants—together with those for teacher preparation and for state departments of education—"shall be available only to those states which, during the year preceding the year for which the apportionment is made, have provided from state revenues . . . a total not less than the total spent for such purposes combined in the school year ended 1938." [87] Behind this lay the definite assumption that, in financing education, the states and localities needed help rather than stimulation. One other condition in the bill was that a state, to secure grants for elementary and secondary education, had to provide a plan for the distribution of the grants *within* the state "in such manner as to assist effectively in equalizing educational opportunities." [88] This is not to say that the plan deemed most

[85] Some of the school buildings recently built or rebuilt with emergency federal aid are poorly located even for present needs. Others will become prematurely obsolete if existing local population trends continue in the areas they serve. *Ibid.*, p. 66.

[86] *Ibid.*, p. 65.

[87] See S. 1305, section 52. A failure to comply "due to acts of God or other circumstances over which such State has no control" was sanctioned.

[88] Section 51 (b).

effective or desirable by the federal authorities had to be provided; so long as *some* equalization was provided, the state plan could not be rejected.[89] And the bill went beyond deëmphasis of federal conditions since, in a gesture of supererogation, it provided in section 1 a "bill of rights" which specified state and local educational powers.[90]

The bill did contain, in the proposed grants for the administration of state departments of education and improved teacher training, an intended corrective for the general paucity of direct federal controls. If improvement in the quality of certain "strategic factors" in the educational system could be stimulated, then all might be well. One strategic factor was the teaching staff, and therefore special grants were to be offered to improve its quality. Even more important in this respect were the state departments of education, since upon them might be placed a responsibility for supervision of local expenditures which the federal government itself dared not exercise. If state departments could be staffed with a personnel adequate in quality and training, and with security of tenure, they might provide an effective barrier against misuse of the large federal grants for elementary and secondary education. Therefore the Senate bill (S. 1305) declared that, in order to secure grants for the administration of departments of education, a state must "provide by law a system for the appointment and tenure of personnel . . . upon the basis of merit and efficiency and without regard to political considerations."[91] Here was one of the few instances in the bill of a condition which would require a significant alteration in the current practices of many states. It should, however, be noticed that the "merit system" was to be state-devised, and that a state which did not comply with this condition would not be debarred from receipt of all or any of the other grants.

One must conclude that the bill showed a tenderness for state

[89] An earlier bill gave the United States Commissioner of Education a broader power to approve or disapprove plans.

[90] See also sections 44, 206, 309. The later bills had the same tenor. Senator Thomas in discussing the 1943 version insisted that "there is not one iota of Federal control in this bill." (*Congressional Record,* Oct. 14, 1943, p. 8398.) Senator Taft, an opponent of the bill, seized upon this weakness. He declared that "if the purpose of the Federal subsidy is equalization then we must necessarily impose Federal regulation which will bring about equalization." (*Ibid.*, p. 8525.)

[91] Except that "members of boards within the State, elected officials therein, and its chief state school officers" were excluded. Section 51 (a) (8).

autonomy throughout its provisions. The aim was to assist "in equalizing educational opportunities . . . without Federal control over the educational policies of States and localities." During the hearings the argument was repeatedly made that the adoption of good educational methods must depend, not upon federal pressure, but upon conviction; and that if the states had the financial resources, adèquate and efficient facilities would soon follow. This attitude can, of course, be glorified by calling it a philosophy of education, and certainly there are values in local control of education which are beyond price. Yet it is wrong to be naïve about federal grants in aid. Both experience and logic indicate that to give grants without adequate conditions is to invite some misuse of federal money, and when the grants are equalizing and non-matching, the dangers are multiplied. If there is a federal interest in general education which justifies grants, there is, as a concomitant, a justification for some measure of federal supervision. About the proper extent of this supervision disagreement is inevitable, but the bill under examination made extreme concessions to state and local autonomy. The suspicion cannot be avoided that its earnest proponents, convinced of the desirability of federal aid for education, attempted to frame a bill with the mental reservation that, once enactment is secured, whatever is wrong can later be made right.

The Advisory Committee on Education argued also that the grants which it proposed, especially for elementary and secondary education, would be so small a fraction of current state and local expenditure that abuses need not be feared. It is true that $40,000,000—the initial grant for elementary and secondary—was only 2.4 per cent of total current expenditure in 1934–35; but here as always an overall figure conceals the important fact that the range runs from 0.16 per cent for Nevada and California to 19.8 per cent for Arkansas and 16.6 per cent for Mississippi. To give grants enabling some states to increase their expenditure by one-sixth would be of real consequence. And what of the situation in the sixth year of the scheme when the total of grants for elementary and secondary education will have risen to $140,000,000? One cannot predict the level of state–local expenditures (exclusive of grants), but at least a possibility exists that there will be no appreciable increase, in which case the federal grants would, for some states, amount to 60 per cent of their

current expenditure. The bill requires only that state–local expenditure be maintained at the pre-grant level, i.e., that grants be not used as a substitute for state–local expenditure.

The bill also is neutral toward the actual methods of educational finance used in a state. Two states which have an equal educational need will receive the same amount of grants regardless of the goodness or badness of their system of taxation and of the distribution of their educational expenditure. It is, of course, the opinion of the sponsors of the scheme that all the poorer states are already making an adequate effort; but even if this is conceded, the fact remains that some are not doing as well as others and that the proposed method of grants imposed no pressure for improvement.

There is, indeed, something incongruous about a bill which contained a complicated equalization basis for the distribution of grants to the states and yet did so little to insure that, *within* states, equalization would be passed on to the local units. The bill required only that states submit plans to the United States Commissioner of Education which contained some measure of equalization, and if this were done the commissioner had no power of rejection or compulsion.[92] A study prepared for the Advisory Committee on Education discovered that in fewer than one-third of the states were plans in operation which gave "a reasonably equitable distribution of aid to those areas that probably have the greatest need and certainly have the least ability."[93] It would, therefore, seem that the indecisive and temporizing provisions of the federal-aid bill were unwise.

On one other major issue the recommendations of the Advisory Committee (and the provisions of the bill) were inconsistent with its own findings. The committee, after a survey of the existing

[92] At the hearings, Mr. F. W. Reeves, the chairman of the Advisory Committee, stated: "If the plan handed to him [the commissioner] does effectively reduce educational inequality, he has to accept it even though he may recognize that it is not nearly as good as one that he might think that he could make himself." Hearings, Federal Aid to Education Act of 1939, p. 63.

[93] Newton Edwards and Herman C. Richey, *The Extent of Equalization Secured through State School Funds* (Staff Study No. 6 prepared for the Advisory Committee on Education, Washington, 1939), pp. 17–18. One member of the Advisory Committee, Mr. T. J. Thomas, submitted a minority report in which he said: "I believe that no State is entitled to receive Federal aid until it has made a reasonable beginning in the work of equalizing educational opportunities within its own borders, even though to do so may require the amendment of state laws or even state constitutions." *Report*, p. 223.

federal grants for education, was emphatically of the opinion that the piecemeal approach had been an error. Aid had been extended to segments of the field of education and this parcelization had distorted the structure of state–local expenditures. The problem of financing education, so the committee had argued, was unitary in nature. It is, therefore, surprising to find that the parcelization is both continued and extended. What is the explanation of this inconsistency? Undoubtedly it lies in the obstacles which the committee saw in the way of federal intervention in the field of elementary and secondary education. A unified scheme would require the consistent and unqualified application of federal conditions throughout, and the committee was aware that these would be unacceptable to Congress. But if the educational grants were segmented, with imposition of a minimum of federal conditions where public and Congressional sensitivity was high and of stronger conditions where it was low, then the whole might be made palatable. A committee likes to recommend a plan which has some chance of acceptance, even by the sacrifice of consistency.

If this plan ever reaches the floors of the Congress, it will be very vulnerable to political attack. Equalizing grants are designed to bring about a redistribution of wealth among the states, and in this case the redistribution would occur on lines which are sharply regional. Twelve Southern states, with 26.3 per cent of the population of the nation, could secure 63.7 per cent of the educational grants. Critics will jibe that "the bill is a bill for the relief of the Southern states." [94] As long, moreover, as the federal budget is unbalanced, critics will ask where the money for this large and continuing new expenditure is to be found.[95]

The work of the Advisory Committee in mapping out a road for improvement of the American system of education is a great pioneer achievement. One must believe that, within a few years, progress along this road will be made. No function so indisputably within the scope of government offers so good a prospect

[94] U.S., 76th Congress, 1st session, Senate Report No. 244, Part 2, p. 4, statement of Senator Taft.

[95] "If the proponents of the bill wish to sell the American people a bill of educational goods, they should at least show them where they are going to get the money to pay for it. To borrow for a current emergency may be justifiable, but to borrow for a continuing annual deficit can only lead to bankruptcy or repudiation." *Ibid.*, p. 3.

for constructive statesmanship, and the intricacies of federalism ought not much longer to be permitted to retard progress. Beyond question it is our federal structure which has been a barrier. Governmental expenditure for education raises no important dispute between the conservative and the liberal, because education is a function clearly within the agenda of government. The nub of the dispute in the United States relates to what level of government should handle the expansion, and progress should not be delayed until the disputants who are concerned with delineation of the proper spheres for the federal government and the states have resolved all the issues. Something should be done promptly to enlarge federal *financial* participation.

The exact pattern of this participation does not much matter so long as a few broad principles are accepted and major pitfalls are avoided. The safest plan would be to use federal grants in aid, and as a beginning, grants in aid of general education, including therein preparation of teachers and better organization of state departments of education. The grants should be equalizing and the principal basis for their allocation should be per capita income modified so as to take account of the distribution of income within each state. The aim should be to provide a minimum standard of educational services in every state, and this minimum at the outset should be set at a level so low that the poor states, aided by federal grants, have a reasonable target at which to point. This will mean that the rich states receive no grants or only nominal grants, but it will also mean that the poor states do not receive sudden and large accretions to their educational expenditure. In the field of education progress is not made by jumps.

A necessary accompaniment of this sort of system should be imposition of strong federal conditions, couched in the most general and flexible terms. Unless the conditions are strong, they cannot be general and flexible. Detailed standards can only be irritating and futile. This is the critical feature. The tradition even of the best of the federal grants has been to start with weak conditions and then to build controls as expediency dictated. With respect to education this tactic is both too slow and too small in promise. Education as a governmental function will not be revolutionized in the next twenty years as highway building was

in the last twenty, and therefore a weak beginning cannot be expected to ripen into a substantial accomplishment.

Among the necessary federal conditions should be that the states set up strong departments of education operating under a merit system, that the teachers measure up to objective educational standards, that the state system of educational finance be equalizing to a significant degree, that plans be laid for examination and improvement of local school organization and districting. The routine requirements of audits and reports are of course necessary, as well as the federal power of withholding grants. If these conditions are satisfied, the actual framework of grants outlined in the *Report of the Advisory Committee* are satisfactory with respect to aid to elementary and secondary education, improved preparation of teachers, and construction of school buildings to facilitate district reorganization.

The hodgepodge of federal grants for education now outstanding requires pruning and consolidation. With the sole exception of vocational rehabilitation, no expansion should be made. All the evidence indicates that in these specialized fields of education the poorer states at least have gone further than they should.

CHAPTER VI

PUBLIC ASSISTANCE

THE FEELING that certain categories of destitute persons—the aged, the blind, dependent children, veterans—should not be subjected to the stigma of poor relief received early, if not widespread, recognition in the United States. Their need, it was argued, arose out of extenuating circumstances or was completely outside their control, and after 1910 special state legislation providing categorical relief spread haltingly over the nation. By 1929 twenty states had legislated about relief for the blind, forty-five about dependent children, ten about the aged.[1] There was, therefore, some realization that responsibility for these groups should not be entirely local. But the practical significance of the steps taken is exaggerated by the figures just given, because in some states administration was left in local hands; in some, financial participation by the state government was slight; and in some, local governments—counties—were allowed the option of coming into or staying out of the state scheme.[2] Of a total state–local

[1] A. E. Geddes, *Trends in Relief Expenditures, 1910–1935* (Research Monograph X, Works Progress Administration, Washington, 1937), p. 3.

[2] "Generally speaking, with the exception of care of dependent children by state agencies or institutions, the local political subdivisions of the states were charged with the responsibility for administering and financing the various types of aid. State participation in administration and financing was most apparent in the category of dependent children because of the general practice of housing such children in state institutions. A substantial minority of the states with blind assistance laws provided financial aid to the localities and exerted some supervision over them. With reference to poor relief and old-age assistance, however, the states assumed practically no responsibility for financing and administration. State legislation for assistance to the aged furnishes an excellent example of the restricted application of most state provisions for categorical relief. Seven of the ten state laws on the subject in 1929 left the adoption of the system to the discretion of each county. Many of the counties operating under such 'county optional systems' provided no old-age assistance. In addition, sixty-five was the lowest pensionable age, and half of the ten states required that applicants be at least seventy years of age. Residence requirements were likewise highly restrictive, residence of from ten to fifteen years within the state being required. Applicants satisfying these and other requirements could look forward to maximum pensions ranging from $250 a year in Kentucky to $30 a month in a number of states. Actual average pensions, however, were considerably below these figures." E. A. Williams, *Federal Aid for Relief* (New York, 1939), pp. 12–13.

expenditure of $58,400,000 for categorical relief in 1930 (of which nearly $30,000,000 was for dependent soldiers and sailors), the state governments were perhaps carrying one-half.[3]

The depression struck the aged with special weight as savings and jobs were lost, and this group was the first to propose remedies not in accord with earlier traditions. Bills for their assistance by old-age pensions were presented and favorably heard in Congress itself. But no legislation resulted, because President Roosevelt was desirous of a broader approach to the issues of social security. On June 8, 1934, he told Congress that he intended to appoint a Committee on Economic Security which was to report to Congress a coördinated and comprehensive plan. This committee, consisting of the Secretary of Labor (Frances Perkins), the Secretary of the Treasury (Henry Morgenthau), the Attorney-General (Homer Cummings), the Secretary of Agriculture (Henry Wallace), the Federal Emergency Relief Administrator (Harry Hopkins), was set up and it in turn appointed other committees, drawing upon the services of technicians and the public. On January 15, 1935, the cabinet committee reported, and a few days later legislation founded upon this report was introduced into Congress. On August 4, 1935, the Social Security act became law.

What must be noticed at the outset is that only one phase of this omnibus law was to be administered on a purely federal basis. Old-age assistance, unemployment compensation, assistance to dependent children, maternal and child care, services for crippled children, care of neglected children, vocational rehabilitation, pensions for the blind, public health work—all were to be handled on a federal–state basis. About most of these there was a unanimity of opinion that no other plan was possible; about one of them, unemployment compensation, a sharp dispute developed concerning the desirable and possible degree of centralization. The group which favored federal–state coöperation prevailed over those who preferred a purely federal scheme. But the breach in opinion has never been healed, and the controversy will require further attention.

Old-age insurance became strictly a federal responsibility, and only the briefest mention can be made of it here. State and lo-

[3] Geddes, *op. cit.*, gives sources from which estimates and trends can be calculated.

cal participation in a long-range insurance scheme seemed out of the question, because the population and the industries of the United States are exceptionally mobile, and no calculations looking ahead a generation or more could be accurate if made on a state basis. "The operation of 48 separate systems of old age insurance would involve virtually insuperable administrative difficulties, excessive costs and almost certain failure in many states." [4]

Even if the administrative and technical problems could be overcome, a patchwork system of old-age insurance resting upon state volition would fail to meet the long-run problem of the aged. Some states might not act at all, state standards would vary, and as a result many people would reach old age with nothing to look forward to except old-age assistance. Accumulation and handling of the large reserves required by old-age insurance required federal action. One could not argue that state administration was desirable for the purpose of discovering and adapting new techniques through experimentation, because what was desired was known, and standardized procedures could be devised. In short, considerations of administration, finance, and equity all pointed to a federal system, and although the actual system adopted in 1935 has been under a constant fire of criticism and has been changed in important particulars, there has been no suggestion that a federal–state scheme would be an improvement.

The immediate needs of the aged poor were to be met not by old-age insurance, but by provision of old-age assistance financed on a non-contributory basis out of federal–state–local treasuries. Old-age insurance and old-age assistance were thus complementary. Moreover, a practical issue of government finance was involved. The number of aged people in the United States is certain to increase both absolutely and relatively. Unless, therefore, some method of "coöperative thrift"—that is, the compulsory contribution to old-age insurance—was provided, the direct cost to government of old-age assistance would become very great.[5]

[4] Social Security Board, *Old Age Security* (Washington, 1937), p. 200.

[5] So far this insurance has made only a small impact upon old-age assistance, since in the spring of 1941 only 200,000 persons over 65 years of age were on the insurance rolls, compared with over 2,000,000 in receipt of old-age assistance. But the insurance program is still new, its coverage is restricted, and a good many employables over 65 years stay at work.

Old-Age Assistance

In the past quarter-century no phase of social legislation has received so much and so favorable attention from government in the United States as assistance to the aged poor—old-age pensions. From 1907 on, commissions of investigation were appointed, and without exception the reports condemned the "poor farms" which were the principal means for the care of the destitute aged. The commissions were, however, far from unanimous as to the remedy; and they were at first unprepared to recommend even state fiscal assistance. Responsibility was held to fall first upon the family, and second upon local governments. Not until the early 1920's did this attitude change; but then, partly as a consequence of the sharp slump of 1920–21, and still more because of a shift in social philosophy during the period of the war, expert opinion came to hold that the state governments had a responsibility. Perhaps the growth in the proportion which the aged were of the total population may have pushed opinion in the same direction.

In 1923 three states—Montana, Pennsylvania, and Nevada—passed old-age pension laws [6] and it seemed that a trend had started. But constitutional hurdles, governor's vetoes, and widespread prosperity intervened and "at the end of 1928, after six years of agitation, there were only six States and one territory which had made provision for their aged." [7] All the state laws were of the optional type—that is, they left the adoption or rejection of the old-age assistance system to the counties, and for this reason the laws had a very limited effect. In the six states there were slightly more than 1,000 recipients of old-age grants, and the total amount spent in 1928 was only about $200,000.

The next six years brought more rapid progress, and by the end of 1934 twenty-eight states and two territories had old-age assistance statutes. But in three states the system was inoperative because of lack of appropriations, and in only ten was the system state-wide. The laws set the age limit at 65–70 years, they restricted the grants to citizens, and they usually set the required

[6] Arizona and Alaska had acted in 1915, although the Arizona law was promptly held to be unconstitutional.

[7] Colorado, Kentucky, Maryland, Montana, Nevada, Wisconsin, Alaska. See *Social Security in America* (Committee on Economic Security, Publication No. 20, 1937), pp. 160–61.

period of residence in the state at fifteen years. There was, moreover, a wide variation in the percentage of eligible persons covered, in the amounts of the average grants, and in the degree to which the state governments shared the cost with and exercised supervision over the localities.[8] Thus while the insistent demand for legislation had brought some results, the aged poor were not receiving similar treatment over the nation; and with the stringency which depression had brought to state and local finances, it was clear that further progress would be devious and difficult. The advocates of old-age pensions naturally turned to Washington. Why was not care of the aged poor in part a national responsibility? Why should not the federal government give leadership to the states by grants in aid with conditions attached which would encourage more adequate coverage, higher standards and better administration? The American Association for Old Age Security, headed by Abraham Epstein, pressed this program earnestly upon Congress, and in 1934 a bill providing grants equal to one-third of the expenditure for old-age assistance was reported favorably by the Labor Committee of the House and the Pensions Committee of the Senate. Only objection at the last moment by Senator Gore blocked its passage in the Senate, and only doubt about the attitude of the president held it back in the House. At this point the president appointed the Committee on Economic Security and the plan which it submitted early in 1935 deserves careful attention.

When the decision was taken for federal action about old-age assistance, the predominant opinion held that the natural and inevitable method of attack was by grants in aid. More than half the states were already in the field, and it seemed wise to build upon these foundations. Old-age assistance is a form of direct relief, and here the federal government has neither facilities nor qualifications for administration. Some variation in standards of provision over various parts of the nation seemed proper. Differences between North and South, between city and country, the existence of a large Negro population, made impossible a uniform national standard of provision for the aged poor.

[8] *Social Security in America*, pp. 163–64. The percentage which recipients were of population of eligible age varied from 0.5 per cent in Maryland to 27.1 per cent in Montana. The average monthly grant varied from $0.69 in North Dakota to $26.09 in Massachusetts.

That there should, however, be a *minimum* standard over the nation was a reasonable proposition, and it was hoped that this could be secured by attaching conditions to the federal grants. A plan of grants on the traditional pattern would secure the advantages of federal–state coöperation. The bait of financial assistance would attract all the states into the scheme; it would enable the federal government to spur on laggard areas to extend their coverage and to improve administration; it would make possible a rational sharing of the fiscal burden. This is, of course, the familiar technique of the conditional grant, and the interest lies in seeing what conditions were actually imposed. The differences in standards and practices from state to state, while making some minimum of conditions desirable, also made it difficult to settle upon what this should be. To impose no conditions would turn the grants into gifts and would imply that the federal government had no interest in how old-age assistance was provided; too many conditions and too much scrupulosity in supervision would assume a federal interest in and knowledge of state conditions which did not exist. Some middle course had to be found.

The Committee on Economic Security and its technical advisors were well aware that they faced here a problem of federalism, and they recommended a measure which, to most students, seemed satisfactory and inoffensive. In place of a grant of one-third of the cost of assistance, which earlier proposals had suggested, a grant of one-half was to be offered. The justification of this greater generosity was that, while the need for old-age assistance had increased, the fiscal position of the states and localities had deteriorated. It was hoped, moreover, that the larger federal grant might make possible stricter federal conditions. A top limit of $15 per recipient was set for the federal grant, although this was not to mean that any limit—such as $30—was set for the amount which could be paid by a state. Needy persons over sixty-five years of age,[9] who were citizens and who had resided in the state for five of the nine years preceding the date of application, were not to be denied assistance, and the assistance was to be "at least great enough to provide, when added to the income of the aged recipient, a reasonable subsistence compatible with

[9] Until January 1, 1940, the age limit might be 70 years. This meant that the states were given time to bring the limit down.

health and decency."[10] Moreover, a plan, in order to be acceptable for grants, had to be state-wide in scope; it had to provide for "substantial" participation by the state and for establishment of a state welfare authority which would be responsible for administration.

These provisions required a significant lifting of existing standards, although they were both reasonable and moderate. If the federal government was to provide half of the cost of old-age assistance, it was fair to ask that the state governments participate more vigorously and generously than in the past; and it was consistent with the theory of federalism that the federal government should deal with the states rather than with local governments.

The proposals of the Committee on Economic Security were, however, mutilated by Congress and especially the Senate, the general effect being to reduce the conditions imposed upon the states as the price of federal grants. Let us notice the Congressional reaction. The condition that a state plan should provide the aged recipient a subsistence "compatible with health and decency" came under vigorous fire during the Senate hearings, as the following colloquy between Senator Byrd and Professor Witte (who was the executive director of the Committee on Economic Security) will indicate:

Senator Byrd. As a matter of fact you have dictatorial power in this legislation over what the State is permitted to do. You can deny the whole payment to the State. . . .

Mr. Witte. The pension must be an adequate amount to support the old couple in decency and health.

Senator Byrd. The administration at Washington is to be the judge as to whether or not the State receives any of the appropriations from the Federal Government. . . .[11]

And again:

Senator Connally. . . . In some States on account of living conditions, and all that, they might feel that they would not want to pay more than $5 or $10 for old age pensions. Under this bill if the States do not pay more than that, it [sic] will not get anything. . . . The Administrator is given the power to step in if he wants to and say, "Here you are not paying enough

[10] U.S., 74th Congress, 1st session, House Report 4142, sec. 4(c). Several other features of eligibility are neglected here.

[11] U.S., 74th Congress, 1st session, Senate Hearings before the Finance Committee, Social Security Act, pp. 69–70.

down there. We will not give you anything." . . . The point I make is that $5 or $10 a month might not be all that we would like to give, but if the State cannot give more why should not the Federal Government give a similar amount, to match the amount that the State gives? [12]

The result of this criticism was that, while the conditions which referred to the citizenship, residence, and age of applicants were left in the bill, the others were struck out or emasculated. The clause which referred to maintenance of a standard "compatible with health and decency" disappeared; a state plan had to be state-wide and there had to be state financial participation, but the adjective "substantial" was dropped. And the tenderness of Congress toward the states was evidenced further by the provision that, if constitutional obstacles stood in the way, a state plan which did not provide for state financial participation before July 1, 1937, should be acceptable. Thus the Senate Committee on Finance made no idle boast when it said that "the supervision given to the Federal agencies . . . has been carefully circumscribed so that there may be no unreasonable encroachment upon the States from Washington. Less Federal control is provided than in any recent Federal aid law." [13]

Old-Age Assistance in Operation: Its Rapid Growth

Even before the Social Security act was passed, the nation had been at first amused and then disturbed by the rise of crackpot pension schemes, of which the most famous bore the name of Dr. Townsend. During the years after 1935 the Townsend scheme remained in the public eye, and while it professed to be a general panacea for the social ills of the modern state, the drive behind it came from the older age group—"the senior citizens"—who were to demonstrate once again the amazing influence of an organized pressure group under the American political system.

The general basis and the curious arithmetic of the Townsend plan need no attention here, but its influence upon the social security legislation is of great importance. Undoubtedly the original act attracted some support in Congress because it was regarded as a way to sidetrack the agitation; and when, through

[12] *Ibid.*, p. 247. Senator Wagner in his opening testimony (p. 8) had raised unnecessary fears about this, and the fact that, in the original bill, Mr. Hopkins was to be the administrator, raised further fears.

[13] U.S., 74th Congress, 1st session, Senate Report No. 628.

passage of the act, the Townsendites were repulsed in Washington, they turned back upon the states. Their pressure caused the state legislatures to frame, as quickly as possible, plans for old-age assistance which could be presented to the Social Security Board for acceptance; and the Board itself, influenced by the hectic political atmosphere, hastened to approve the state plans after superficial examination. This haste could be rationalized by arguing that the first step was to get a federal–state system of old-age assistance in effect over the nation and that improvement in the plans and administrative niceties would come later.[14]

The pace at which old-age assistance spread over the nation was remarkable. By September 1938, all of the states, as well as the District of Columbia, Alaska, and Hawaii were administering plans approved by the Board. The following table shows the increase in the numbers of and in the monthly payments to recipients:

TABLE 15

OLD-AGE ASSISTANCE, 1933–1940

	Number of recipients	Payments to recipients
December 1933	107,000	$ 2,139,000
" 1934	206,000	3,919,000
" 1935	378,000	6,539,000
" 1936	1,106,000	20,788,000
" 1937	1,577,000	30,695,000
" 1938	1,776,000	34,740,000
" 1939	1,909,000	36,838,000
" 1940	2,067,000	41,839,000

In the seven years from December 1933 to December 1940, both the number of recipients and the payments to them had grown over nineteenfold. For the fiscal year 1940–41 of total payments of $505,053,000 to recipients, the federal government provided $251,254,000 (49.7 per cent), the states $205,038,000 (40.6 per cent), and the localities $48,771,000 (9.7 per cent). In twenty-seven states the localities did not provide any part of the payment, and in only one (Kansas) did they provide a larger share than the

[14] In its first Annual Report, 1936, p. 11, the Board declared "that the immediate necessity for aiding the needy outweighed considerations of administrative nicety. Smoother operation and more highly perfected plans will follow further experience of the Board and of the States."

state governments.[15] A substantial broadening in the basis of financial participation had been achieved in spite of the fact that the Social Security act merely required financial participation by the states without specifying any minimum amount. The basis of administration had also been broadened, since the act required designation of a single state administrative agency both in order to facilitate federal supervision and to encourage state participation.

Withholding of Grants

As is well known, this rapid expansion has not been wholly healthy, and the Social Security Board has found that the sanctions which it can apply to check state waste of federal money are not strong. The act did put upon it the job of determining whether or not the state administration is "proper" or "efficient," and yet, by an anomaly, the Board was prohibited from setting standards for state personnel. It would be wrong to say that the Board was powerless to affect personnel, because it found ways of bringing pressure upon the states, and it exercised to the full its right to demand statistical information from them.

The Board had, besides, the ultimate sanction of any grant measure—withholding of federal grants, although the obstacles in the way of this action are as plain as a pikestaff. Mr. Altmeyer, the chairman of the Board has said: "It is an awful responsibility to place upon any administrative agency when it knows that there are hundreds of thousands of people dependent upon the grants from the Federal Government, to withdraw those grants. . . ."[16] Yet this penalty cannot be allowed to become obsolete, since Congress in a federalism will seldom permit the imposition and exercise of other less drastic, but more detailed, controls. So it had been with old-age assistance, and before long the Board, faced by the recalcitrance of certain states, was driven to withholding of grants. The first case was Illinois. After extensive investigation of state administration and a public hearing as required by the act, the Board stopped its grants on July 27, 1937, because there had not been compliance with proper finan-

[15] *Social Security Bulletin*, vol. 3, no. 1 (January 1940), p. 3.

[16] U.S., 76th Congress, 1st session, House Hearings before the Ways and Means Committee, Social Security, vol. 3, p. 2393.

cial and accounting procedures, because a fair hearing for applicants had not been provided, and because of generally inadequate administration. A month later the state corrected these faults and grants were resumed.[17] Early in 1938, for similar reasons, grants were suspended in Oklahoma, not to be fully resumed until July 1939.

The experience with Ohio was much more serious in its political repercussions and it deserves fuller discussion. From the very beginning old-age assistance in this state had been a political football. Not only were there observable deficiencies in administration, but more serious charges were bandied about in the press. In the summer of 1936 Governor Davey increased pensions by $10 a month and then asked the pensioners to give him their political support.[18] After his reëlection the pensions were reduced, and in August 1938 the Board declared that it would hold a public hearing to see if Ohio was complying with the law, and this was done although no representative of the state put in an appearance. Late in September the Board issued its findings. Beyond all question, personal and political considerations had dominated administration. Delays in handling cases were common, and a very important factor to a recipient in getting assistance had been political endorsement. Federal audits disclosed numerous discrepancies and gaps in the records. In short, not the slightest doubt remained that, principally because of Governor Davey, old-age assistance in Ohio was a public scandal. The wonder is, perhaps, that the Board intervened so late, and the prevalent assumption has been that it was unwilling to become involved in the bitter fight already in progress between Governor Davey and Mr. Hopkins. On September 29, 1938, the grants to Ohio were stopped. Two months later, after the political defeat of Davey and after the state improved its administration of old-age assistance, the grants were resumed.

Unfortunately this did not end the matter. A vigorous agitation was begun in Ohio to recover the $1,340,000 in grants which had been lost by suspension. The legislature memorialized Congress, and Representative Jenkins introduced a bill for the purpose. Why, it was argued, should the people of Ohio, and par-

[17] *Annual Report of the Social Security Board,* 1936–37, p. 92.

[18] Abraham Epstein, "Killing Old Age Security with Kindness," *Harpers,* July 1937, p. 187.

ticularly the aged poor, suffer because of executive wrongdoing? Here was a state which because of mistakes—or worse—of its executive, and because, as was alleged, of a political squabble between the executive and Mr. Hopkins, had been punished by a federal administrative body. A more legalistic plea was that, while the Board had the right to withhold payments, it could not forfeit them, and that, therefore, reform should bring restitution.[19] The fact that this attitude and this interpretation would leave the federal government helpless against improper state administration was passed over. The bill of Mr. Jenkins passed the House unanimously and the Senate by unanimous consent (after slight amendment), only to meet with a presidential veto on January 24, 1940. The veto pointed out that this phase of the Social Security act called for federal–state coöperation and therefore reasonable efficiency in state administration; that passage of the bill "would seriously endanger the success of the entire Social Security program" by negating "the sole means of assuring an effective administration and disposition" of the federal grants; [20] and that the suggestion that the whole situation be reopened, so as to discover how much had been misspent in Ohio, was utterly impracticable. Mr. Jenkins appealed to the House to override the veto, but without success.[21]

While grants have been suspended in only three states, the Board has almost been provoked to action in several others, and it has often been long-suffering to the point of indulgence. Abraham Epstein, one of the pioneer workers for social security legislation, expressed the fear in 1937 that old-age assistance was "merely becoming the latest link in the long chain of American pension systems under which pensions to widows of the War of 1812 were paid about one hundred and twenty years after the close of that war, and Civil War pensioners increased from

[19] See U.S., 76th Congress, 1st session, House Hearing before the subcommittee of the Committee on the Judiciary on H.R. 5118, July 12 and 19, 1939, pp. 3–4.

[20] *Congressional Record,* vol. 86, p. 650.

[21] He asked his colleagues not to forget "that the rights of a sovereign State have been invaded by a Federal Bureau without authority. . . . If our Governor made a mistake in the distribution, who is there in this Government to say anything about it? He was elected by the votes of the sovereign peoples of Ohio. . . . It is terrible to contemplate that one little professional bureaucrat can punish a sovereign state to the extent of denying that State her just dues to the extent of $1,333,000. . . ." *Ibid.,* pp. 652–53, p. 656. The vote to override the veto was: yeas 171, nays 152, not voting 100.

127,000 in 1866 to almost a million thirty-six years later."[22] The Townsend movement was terrorizing legislators over the nation, the administrative machinery was creaking, and in some states, notably Colorado, payments for old-age assistance forced curtailment of other services and even threatened the fiscal position of the state government. In Oklahoma it was charged that the number of pensioners in some counties exceeded the number of people over sixty-five years of age.

Interstate Variation

Let us look at some of the statistics of old-age assistance. Table 16 shows the wide interstate variation which exists in the *number* of recipients per 1,000 of estimated population sixty-five years or over. While for the nation as a whole in December 1940, 26.1 per cent of persons over sixty-five years of age were in receipt of assistance, at one extreme in Oklahoma the figure was 63.0 per cent, and at the other in Delaware it was 12.0 per cent. The relative poverty of some states might, of course, be a legitimate explanation of a large percentage of pensioners, but it by no means fits the facts. Vermont and Maine are poor states, if tested by per capita income, and they have relatively few pensioners; Nevada and Montana by the same test are rich states and yet they have many pensioners. And while Colorado and Arizona are, by this measure, a little (about 12 per cent) poorer

TABLE 16

Number of Recipients of Old-Age Assistance per 1,000 Estimated Population 65 Years and Over, December 1940

Highest ten states	Number of recipients	Lowest ten states	Number of recipients
Oklahoma	630	Pennsylvania	161
Colorado	517	Rhode Island	155
Utah	506	Maine	154
Arizona	500	New York	152
Louisiana	457	Connecticut	150
Texas	423	Vermont	134
Florida	397	Virginia	129
Montana	394	New Jersey	126
Nevada	386	New Hampshire	125
South Dakota	356	Delaware	120

[22] Epstein, in *Harpers*, July 1937, p. 185.

than New Jersey, this difference hardly explains why they should have four times as many pensioners.

The table below indicates that the average *amount* paid per recipient of old-age assistance also is subject to remarkable variation. The average figure for the nation as a whole in December 1940 was $20.24, with Arkansas at one extreme paying only $7.87, and California at the other paying $37.87. This time relative riches and poverty offer a better explanation. All the states

TABLE 17

AVERAGE MONTHLY PAYMENT PER RECIPIENT OF OLD-AGE ASSISTANCE, DECEMBER 1940, PER CAPITA INCOME, 1939

Highest ten states	Payment per recipient	Per capita income	Lowest ten states	Payment per recipient	Per capita income
California	$37.87	$753	Delaware	$11.42	$848
Colorado	31.66	522	Tennessee	10.11	296
Massachusetts	29.00	705	North Carolina	9.95	302
Arizona	28.01	456	Virginia	9.95	385
Connecticut	27.96	768	Alabama	9.28	243
Nevada	26.55	806	Kentucky	8.91	300
New York	24.91	825	Mississippi	8.60	203
Wyoming	23.91	623	Georgia	8.20	292
Ohio	22.99	608	South Carolina	7.95	268
Washington	22.70	606	Arkansas	7.87	244

which make high average payments have a relatively high per capita income, and all (except Delaware) which make low payments have a low per capita income. But obviously the whole explanation of the variation is not to be found here. Some further part of it inheres in those intangible differences in cultural standards and attitudes which characterize a federal nation. In the northeast the attitude toward family responsibility differs from that in the southwest. In the south as a whole the presence of the Negro affects the number of pensioners put on the rolls and the amount of the average payment. It is impossible to measure the influence of these factors, and the question of how far the federal government should go in attempting to modify their effect raises large issues which will be considered later.

Another reason for state variation in the relative number of, and payments to, pensioners is uneven state administration. At its worst this means political manipulation, and that the federal gov-

ernment should continue to tolerate expenditure of its money for the undeserving which should go to the aged poor is unthinkable. But inefficient administration exists even when there is no political abuse, and one evidence of this is the large number of pending applications which are outstanding in many states. On June 30, 1940, the average for all states was 13.6 pending applications per 100 recipients, but in Georgia the figure was 197.3 and in nine other states it was above 20.0. Bad administration means that, *within a state,* the aged poor are receiving unequal treatment, and it is an unfortunate fact that some poor states, with the most difficult assistance problems, have been guilty of serious delinquency.

New Powers Given the Board

In order to disentangle the justifiable from the unjustifiable elements in state variation, in order to prevent the waste of federal and state money and to prevent squabbles between the Social Security Board and the states, every effort should be made to strengthen administration. The Board has tried to push the states in this direction with fair success. The federal government, besides matching the payments of a state for assistance, also adds 5 per cent to this amount as a grant which can be used to cover cost of administration or for assistance. Some states have used all of it for administration, but the Board found, in any case, that states were unwilling to go beyond matching this grant out of their own funds, even when it was clear that a larger total sum was required to provide adequate administration. The Board therefore requested, in 1939, that the basis of the grant be changed and that the federal government undertake to pay to the states 50 per cent of the necessary cost of proper administration. Congress, however, did not sanction this alteration.[23]

In 1939 the Board, disturbed by the known weaknesses of old-age assistance, asked also that its control over state personnel be strengthened. Mr. Altmeyer, the chairman of the Board, pointed out the dilemma which he faced. He did not wish to endorse extravagance and improper administration; yet the principal weapon in the hands of the Board—withholding of grants—was so drastic, arbitrary, and misdirected, that it could be used only

[23] Yet it did sanction a parallel change with respect to grants for administration of aid to the blind.

in extreme cases and was liable, even then, to arouse the wrath of Congress.[24] Why should not Congress, which had declared in 1935 that the Board should "provide such methods of administration (other than those relating to the selection, tenure of office and compensation of personnel) as are found to be necessary for the efficient operation of the plan," be willing to delete the parenthetical statement? If this were done, and if words were added which required that state plans should provide for establishment and maintenance of personnel standards on a merit basis, then progress might be made in improving state administration. This time the proposal encountered opposition in the House,[25] while in the Senate there was a favorable response. To Senator Barkley it seemed "utterly ridiculous" for the federal government to give money in grants without adequate supervision.[26] The Senate accepted the request of the Board and so, finally, did the House. The Board received, therefore, a new administrative power which it has begun to use. But progress is certain to be

[24] In testifying before the House, Mr. Altmeyer said: "Now the Board is criticized when it does not take action, and it is criticized when it does take action. If it does not take action the people say we are condoning extravagance and improper administration. When we do, the gentlemen of the Congress come full force to the office of the Board and want to know why we have withdrawn the grants; and after we have withdrawn the grants, then the gentlemen of Congress, including a distinguished member of this committee [Mr. Jenkins], want to know why we do not give them back the money lost during the period when, admittedly, they were not in compliance with the standards laid down in the Social Security Act." U.S., 76th Congress, 1st session, House Hearings before the Ways and Means Committee, Social Security Amendments, 1939, p. 2397.

[25] The following colloquy (*ibid.*, p. 2394) illustrates the opposition:

"Mr. Altmeyer. . . . We would not recommend to Congress that there be laid down specific requirements for personnel requirements uniform throughout the country, because we realize that this would be unrealistic and unfair, since the availability of trained personnel by the States varies from one State to another.

"Mr. Cooper (Tennessee). At that point, if you were to suggest that argument, what would you suggest now?

"Mr. Altmeyer. I would suggest that as a requirement, as one of the standards, that the State set up and maintain a satisfactory merit system of personnel.

"Mr. Cooper. Satisfactory to whom—to them or to Washington?

"Mr. Altmeyer. To the Social Security Board.

"Mr. Cooper. That is the point exactly. That puts the domination and control here instead of in the States."

Mr. Cooper expressed the belief that "it may be the part of wisdom to let the program continue substantially as it is, with respect to administration." (*Ibid.*, p. 2398.)

[26] U.S., 76th Congress, 1st session, Senate Hearing before the Finance Committee. Social Security Amendments, 1939, p. 27.

slow, since the words "merit system" have no precise connotation and the Board has indicated its belief that uniformity in standards is not indicated.

Larger Federal Grants

The inadequate payments made in many states to recipients of old-age assistance, coupled with the Townsend agitation, served to bring forward proposals that the federal government provide a remedy. By the 1935 act the federal government promised to match state grants up to a monthly maximum of $15 per recipient, and a majority of the states wrote a $30 maximum in their acts although there was nothing in the federal legislation which required any such limit. Broadly speaking, the richer states tended to approximate (and in a few cases to exceed) an average payment of $30, while the poorer states fell far below it.

In 1939 a large number of proposals were put before Congress. One, sponsored by Senator Connally, proposed federal grants equal to two-thirds of the state contribution up to a total of $15 per recipient, with federal matching above this level. Although the Senate voted his scheme, it was lost in conference committee. During the succeeding debate Senator Connally said: "Let Senators not delude themselves that politicians—and statesmen—are going to be resistant [to a demand for higher old-age assistance]. They have always responded or they have gone home and if there is one thing a Senator or Representative does not want to do it is to go home for good." [27] This gem of political philosophy expressed the attitude of Congress, for it proceeded to raise (effective January 1, 1940) the limit to the amount per recipient which the federal government would match by grants from $15 to $20. For this step nothing good can be said. Only one state, California, was making an average payment in excess of $30, and there was no justification for encouraging it and a few other states to raise their payments so as to take advantage of the higher federal maximum.[28] The great majority of the states had not come

[27] *Congressional Record,* vol. 84, p. 11138.

[28] The absurdity of the $40 a month standard has been indicated vividly by Professor Mabel Newcomer. This standard, she points out, "exceeded the average 1939 income of the entire population of half the states of this country. And if Mississippi were to take full advantage of the federal offer, this state would be taxing its self-supporting population in order to provide the aged with double the income of the taxpayers." "Fifty Years of Public Support of Welfare Functions in the United States," *Social Science Review,* December 1941, p. 659.

even close to absorbing the $15 grant, and to raise a limit which was already beyond the means of most of the states was an insincere gesture. It was made only for reasons of political tactics. Townsendism and its offshoots still were exerting a pressure upon Congress, and Congress believed that, by raising the potential federal grant, it would shift the agitation back to the states.[29]

Distortion in the Grants

The grants for old-age assistance now present the grotesque spectacle of a means by which larger relative sums are paid to richer than to poorer states. A grant plan for a social service which is set up with due observance of a few simple principles—one of which is that the grants are assigned according to *some measure of need* for the service—will redistribute federal revenues from the richer to the poorer states.[30] The poorer states, because of their greater relative need, will get relatively more in grants than the richer states. Suppose, for example, two states, A and B, with populations similar in numbers and age distribution, so that the percentage of persons over sixty-five years is, for example, 5 per cent in each. If A is poorer than B, then its need with respect to old-age assistance is naturally the greater. This is not the way the old-age assistance grants have actually worked. Instead, many of the richer states have secured relatively more in federal grants than the poorer. New York and Kentucky—not extreme cases—may serve as an illustration. In them the relative number of persons over sixty-five years of age is not very different (5.4 per cent of total population in Kentucky, and 5.3 per cent in New York). Yet the amount of federal grants for old-age assistance in 1939 was $22.60 per person over sixty-five years of age in New York, and only $14.20 in Kentucky.

A basic difficulty with the old-age assistance provisions as they now stand is that the federal grants are not so designed as to induce the states to meet a *national minimum standard of need.*

[29] In the summer of 1941 (August 28) a special Senate committee headed by Senator Downey recommended general federal pensions of $30 a month to all persons over sixty years of age not gainfully employed. The recommendation has not advanced in Congress.

[30] For the present the question of how the federal revenue is raised will be neglected. The broad assertion made above is correct whether the federal revenue is raised by progressive or regressive taxes.

The ostensible standard of $40 per month is far beyond the reach of all but a few states, and it therefore distorts the pattern of federal aid. If Congress had, in 1935, offered a grant of $12, for example, which all the states, poor as well as rich, could absorb, then a national minimum of $24 might have been achieved. The richer states would most probably have gone beyond this minimum. By so doing they would have drawn upon their own sources of revenue, but they would not, as at present, have drawn some part of the excess from federal sources. When Congress in 1935, and still more in 1939, set the federal grant at too high a level—when it failed to comprehend the significance of the concept of a national minimum for grants in aid of social services—it inadvertently did an injustice to the aged poor in the less wealthy areas.

A number of related suggestions have been advanced as remedies, most of which assume without proof that all the states which make low average payments for old-age assistance are states of low fiscal capacity. The proposal of Senator Connally—that the federal government contribute two-thirds of the first $15 of the monthly state payments, that is, $10 of the first $15, while continuing merely to match the excess over $15—has been mentioned.[31] An objection to this scheme is that by it many states would likely make $15 their maximum grant, regardless of their financial ability or of the needs of their aged poor. Another objection arises because in all states (rich even more than poor) there are cases of partial dependency in which the grant is a supplement to the income of the recipient. States would be inclined to give more generous treatment to these than to cases of total dependency. If it could be so arranged that only cases of total dependency received the high federal grant, then this latter defect might be remedied, but this would give rise to some serious administrative problems. A similar scheme is that the federal government give to each state an *average* grant of $10 per pensioner, with the proviso that no state be permitted to reduce its expenditure below the amount of some recent period. The same objections apply here. It is simply not correct to assume that all the states which make low payments are making an adequate fiscal effort to meet their responsibilities, and these short-cut remedies,

[31] A variant of this is that the federal government give a low flat grant per recipient with no matching requirement.

by failing to relate federal grants to state fiscal capacity and effort, would serve to bonus the shirkers.

Another proposal which is much more defensible has been suggested by the Senate special committee on unemployment and relief (the Byrnes Committee) and endorsed by the Social Security Board.[32] This is to substitute for the present uniform percentage grants a scale of grants which "would vary in accordance with the relative economic capacity of the State." [33] The Board believes, however, that "there should be a minimum and a maximum limitation to the percentage of the total cost which will be met through Federal grants." These limits might run from 33⅓ per cent to 66⅔ per cent, so that no state would receive grants less than one-third or in excess of two-thirds of the amount it provided from its own sources. The measure of "relative economic capacity" which has been favored is state per capita income.

This proposal for variable grants is so important that it will later receive more detailed consideration, but a few observations will be ventured here. It cannot be denied that, on political grounds, the proposal is extremely vulnerable. As things stand, the states which would receive the higher percentage grants—because they have low per capita incomes—are mostly in the South.[34] This concentration of benefits is, of course, not an unusual feature of legislation in a federal country, but in this case the concentration is so obvious that it does raise a political obstacle.

There is, besides, the question of how best to measure fiscal capacity. Is per capita income the best measure? Should it be supplemented by measurement of the *distribution* of income within the states? And it may be alleged that, while the amount and the distribution of income are excellent measures of the economic and fiscal capacity of a state, they do not represent its

[32] *Proposed Changes in the Social Security Act: A Report of the Social Security Board to the President and to the Congress of the United States,* January 1939, pp. 25–26. In his budget message of January 8, 1942, President Roosevelt said: "I favor an amendment to the Social Security Act which would modify matching grants [for public assistance] to accord with the needs of the various States."

[33] *Ibid.,* p. 26.

[34] Senator Byrnes has said: "I realize I cannot argue in favor of this variable grant without having many persons say that I am making the argument because my own State [South Carolina] happens to come within the States that are affected." U.S., 76th Congress, 1st session, Senate Hearings before the Finance Committee, Social Security Amendments, pp. 286–87.

need for a particular service, such as old-age assistance. Some will say also that a further factor which should receive consideration is the relative cost of living. And finally it can be argued that no measurement of fiscal capacity or need can be so objective and unequivocal that it will be immune from political tampering, and that to cut loose from uniform matching grants is to make the decision over the proper calculation and weight to be given to the various components rest upon a tug and pull in Congress. Possibly a candid appraisal of the dangers and difficulties of a scheme of variable grants would force the conclusion that, at least as a preliminary, a stronger supervision and *more adequate federal controls* should be established.

It would, however, be wrong to permit the recent alarums over old-age assistance to obscure the progress which has been made since 1935. Over 2,000,000 aged persons are in receipt of aid, and the vast majority of them must be classed as needy and deserving. The states select these people and determine the amount of aid which they receive, but the federal government has given advice and supervision at every point; and the performance of these tasks, while still imperfect, has steadily improved. Perhaps the most important of the administrative problems which remains unsolved concerns residence requirements. Aged needy persons may fail to meet the requirements of the state in which they happen to be domiciled (or indeed of any state); some of them who are in receipt of aid in one state and wish to move to another may be unable to do so without losing their eligibility. Difficulties of this sort are inherent in a federal–state program, and they can best be solved by the development of state reciprocal agreements.

Other Public Assistance Grants in the Social Security Act: Aid to Dependent Children

The old-age grants were only part—although fiscally by far the most important part—of a broad program of federal assistance in the Social Security act. Let us look first at the aid for dependent children (mothers' pensions).

Legislation in the United States about mothers' pensions goes back three decades, and by 1934 no less than forty-five states had passed laws. Unfortunately this legislation, like that for old-age

pensions, was ineffective because it usually put the cost upon local governments without being mandatory upon them. Less than half the local governments authorized to pay mothers' pensions were doing so in 1934, and of $37,000,000 spent for this purpose, the state governments supplied only $6,000,000. At the end of 1934 the federal government, through the FERA, was spending about $45,000,000 for the support of families of widowed, separated, and divorced women with dependent children,[35] and the impending liquidation of FERA made it desirable that some more regular type of federal assistance be substituted.

The Social Security act (title IV) authorized grants to the states for dependent children under the age of sixteen years equal to one-third of the total amount spent for this purpose by state and local governments, with the limitation that the federal grant was not to count against expenditure over $18 per month for any one dependent child and over $12 per month for each additional dependent child in a family—that is, the monthly federal grant could not exceed $6 or $4. In order to receive this federal aid, a state government had to put into effect a state-wide plan, to participate financially, and to provide administration necessary for the efficient operation of the plan, although the Social Security Board, which was to exercise federal supervision, was debarred from interference with state personnel.

There was, of course, no logical reason why state expenditure for dependent children should be matched by federal grants only to the extent of one-third,[36] and when in 1939 the Social Security Board recommended that the proportion be raised to one-half, Congress acceded. At the same time it raised the limit on the age of children from sixteen to eighteen years, provided the children were regularly attending school. As was to be expected, this amendment stimulated state participation and increased average payments, but this program has not a great political drive behind it. Competent people have estimated that the actual number of dependent children equals the number of the needy aged, yet at present the number of the latter in actual receipt of aid is nearly three times the number of the former.

[35] *Social Security in America,* p. 249.

[36] Inclusion of expenditures for administration was allowed, whereas in the case of old-age assistance a separate grant for administration was made, equal to 5 per cent of the grant for assistance.

By June 30, 1941, approved plans were in operation in forty-four jurisdictions by which assistance was given to 917,000 children in 380,000 families. Total payments for the fiscal year 1941 were $141,591,000, of which 40.6 per cent came from the federal government, 39.6 per cent from the states, and 19.8 per cent from the localities. The average amount paid per family was $33.01, with a range running from $13.58 in Arkansas to $47.34 in California.

Aid for the Blind

The blind are a group which finds it difficult to earn a normal living, and by 1935 some twenty-five states had laws providing pensions for them. The Social Security act made federal aid available, starting with an annual appropriation of $3,000,000 to be distributed as grants under practically the same conditions as old-age assistance (except, of course, for the age limit).

In 1939 Congress lifted the limit of the grant which it would make in aid of the blind from $15 to $20 a month. By a curious quirk of legislation it also agreed to share one-half of the administrative expenditure of the states for this program, although a parallel recommendation made by the Social Security Board with respect to old-age assistance was not accepted. In June 1941, forty-three jurisdictions participated in this program, and the total payments for the fiscal year 1941 were $13,726,000—federal 47.3 per cent, states 34.2 per cent, localities 18.5 per cent—going to 50,000 recipients. The average monthly payment per recipient was $23.64, with a range from $8.56 in Mississippi to $48.13 in California. This very large variation in payments is exceeded by variations in other particulars. Thus the number of recipients per 100,000 of population ranged from 144 in Florida to 10 in Rhode Island. But comparisons of this sort are so crude as to be nearly useless, since the states have different age limitations and different standards of need, and since the extent of blindness in the population of the different states is not known.

The two portions of the public-assistance program just described are fiscally much less important than the provision for old-age assistance, as the following figures show:

	Total expenditure, in millions of dollars	
	1936–37	1940–41
Old-age assistance	243.2	505.1
Aid to dependent children	40.8	141.6
Aid to the blind	9.0	13.7
	293.0	660.4

For the two minor schemes, as well as for old-age assistance, the Social Security Board has recommended adoption of a variable-grants plan by which the states with smaller economic capacity would receive additional grants. The needs of dependent children are, in its opinion, met less adequately than those of the aged poor and the blind, and it has endorsed liberalization of federal aid for them.[37]

Grants for General Relief

When in the 1930's federal participation in relief began to be debated, public opinion naturally favored the grant of assistance to special categories of needy persons, of which the aged were by far the most important. Looking back, we can see defects in this mode of procedure, and now most social workers would assert that the problem of relief should not be so subdivided. An adequate system would provide that all the needy be cared for according to some sort of minimum standard, and this could now be done—the suggestion is—by adding to the Social Security act a new title providing grants for general relief.

This proposal is worth careful consideration. By the legislation of 1935, Congress established a hierarchy of applicants for relief, and it cannot be doubted that this gave an opportunity for pressure groups to make headway. In some states—Colorado and California are the striking examples—expenditure for old-age assistance has squeezed out expenditure on functions which, by any fair test, are of greater social importance. This sort of defect is, indeed, inherent in any piecemeal use of grants in aid, and it has been aggravated by the form in which the old-age assistance grants were cast. Some time a remedy should be supplied, and when this remedy is sought, part of the answer will probably be found in a unified scheme of public-assistance grants which will include grants for general relief.

[37] Social Security Board, *Sixth Annual Report, 1941* (Washington, 1942), p. 22.

CHAPTER VII

RELIEF AND WORK-RELIEF: FERA AND WPA

The Federal Government must and shall quit this business of relief.

PRESIDENT F. D. ROOSEVELT, January 1935.

When the President of the United States announced withdrawal by the Federal Government, he set a precedent quickly followed by states and in some cases by local governments. The theory that relief is entirely a local problem is, of course, one that state legislators can learn as well as Congressmen and Senators.

GRACE ABBOTT.[1]

THE APATHY OF GOVERNMENT in the United States toward the function of relief and public welfare is a thrice-told tale. Until the present century the able-bodied destitute received almost no favorable attention because of the widespread feeling that work was available for all who chose to work. This country, with a young population, vast resources, and late industrialism, had not been confronted with problems urgent enough to demand extensive governmental intervention. The labor movement was weak, and it was, moreover, long unsympathetic toward federal legislation in the social sphere. The very existence of federalism was also responsible for part of the delay. Toward certain categories of destitute persons—the aged, the blind, dependent children, veterans—a kindlier attitude prevailed even before 1929. But a social program for unemployed employables had not been visualized, and with the great depression previous attitudes were overturned only slowly because the shock seemed to numb the American people.

It would be an exaggeration to say that care of the poor (outside the special categories) was, in 1929, entirely a local function, but the exaggeration would serve to emphasize what was still the dominant fact, since in 1929–30 the local governments bore 95 per cent of the cost of general relief. And at this time *private*

[1] *This Business of Relief*, Proceedings of the Delegate Conference, American Association of Social Workers, Washington, D. C., 1936 (New York: American Association of Social Workers, 1936), p. 24.

expenditure for general relief was approximately 70 per cent of public expenditure. Moreover, the great bulk of this expenditure —both public and private—was for unemployable persons. Almost no provision had been made for relief of employables because of the conviction that this was a matter of individual responsibility. Finally, the federal government at this time held itself aloof from every phase of relief expenditure.

The next decade was, of course, to bring a startling and revolutionary change. Private expenditures for relief, while holding up in absolute amount, became relatively insignificant because of the vast growth in the public effort. The annual total of public expenditure for relief, welfare, and social security increased twenty-five times over the level of 1929, and the responsibilities of the different levels of government were altogether altered. In 1938 the federal government, which before the depression was carrying practically no part of the cost of relief, provided over 65 per cent of the total, while the shares of the state and local governments were 28 per cent and 7 per cent.[2]

Beginning in 1933 the federal government experimented with grants in aid of public works and of relief, as well as with direct administration of work relief; beginning in 1935 it insisted that unemployables (except for certain categories) were a state and local responsibility and it expressed a strong preference for work and work-relief projects as a means of assisting the employable unemployed. Whatever may be the pattern for the future, no reversion to the pattern of the 1920's is presaged. Nobody now questions the existence of a federal responsibility for relief; only concerning the proper limits of this responsibility is there debate.

In this chapter attention will be concentrated on the Federal Emergency Relief Administration and the Works Progress Administration (later the Work Projects Administration). The history of these two agencies brings out all the issues concerning federal–state–local responsibility for provision of direct relief and work relief.

The Early Impact of Depression

The depression after 1929, like earlier depressions, took the people of the United States unawares. But past depressions had come and gone without important governmental action, and there

[2] *Bulletin of the Treasury Department,* August 1939, p. 4.

was in 1930 a widespread assurance that this slump also would be short-lived and that extensive preparations to meet it would be unnecessary. The diversity of the problems raised by the depression hindered the framing of nationwide plans, while the inadequacy of statistics of unemployment made it possible at first to question how serious the circumstances were. Pressure fell first upon private charity and upon local governments. In 120 urban areas, containing more than one-third of the population of the nation, expenditure for relief from private funds rose from $10,300,000 in 1929 to $49,400,000 in 1931 and to $57,100,000 in 1932, while that from public funds rose from $14,900,000 to $88,600,000 and to $208,700,000.[3] After three winters of depression, contributions from private charity became undependable and inadequate; and local governments, faced by a plague of tax delinquency at a time when punitive measures to secure payment were worse than useless, clamored for state assistance. In November 1931 New York had set an example by establishing an emergency relief agency to give advice to the localities and to supervise the distribution of state grants to them;[4] and gradually other states followed. State revenues were more flexible than those of the localities, and something more could be secured by higher taxes upon gasoline, motor vehicles, and corporations, and even by imposition of sales taxes. Borrowing also provided some money for relief, although constitutional and statutory restrictions were a barrier. Local borrowing was often limited in terms of property valuation, or was confined to public works; state borrowing also was hampered by a variety of provisions.[5]

Meanwhile, the federal government, within the limits of precedent and current philosophy, had begun to stir. In the fall of 1930, after the hopes of early recovery had proved abortive,

[3] A. E. Geddes, *Trends in Relief Expenditures, 1910–1935* (Washington, 1937), p. 31.

[4] Mr. Roosevelt was thus the first governor to put state money for unemployment relief at the disposal of the localities, and when a Temporary Emergency Relief Administration (TERA) was set up, Mr. Harry Hopkins become the administrator.

[5] "Only ten states [in 1933] could incur debt for relief purposes without submitting the proposal to a referendum or amending their constitutions" (Harvey J. Bitterman, *State and Federal Grants-in-aid*, Chicago, 1938, p. 151). See also L. L. Ecker-R., "Sources of Local Emergency Relief Funds" (FERA, *Monthly Report*, December 1935).

President Hoover appointed an Emergency Committee for Employment headed by Colonel Arthur Woods. The committee had no federal money to spend. It was to provide state and local governments and industry with information and advice; in particular it was to point out the desirability of expediting construction.[6] Federal construction was to be stepped up and in December 1930, $80,000,000 was "advanced" to the states for highway construction, subject to deduction from the regular grants over the next five years. Then, in August 1931, a new committee—the President's Organization on Unemployment Relief—was appointed with Mr. W. S. Gifford as chairman. Its task was to direct a national drive for relief funds, although once again with no federal contribution.[7] President Hoover and his advisors remained convinced that there was no greater obstacle to recovery than an unbalanced federal budget. It followed as a corollary that any expansion of public works should be accompanied by increased federal taxes; and since heavier taxes would tend to diminish employment in private industry, the final conclusion was inevitably against a spending policy. President Hoover also earnestly held to the position—from which, indeed, no administration had ever departed—that relief of unemployment was not a federal responsibility.[8] His opponents retorted that since the federal government, because of its erroneous policies, had helped create the depression, it had an unavoidable responsibility to help

[6] The chairman of the committee was himself convinced that a large program of federal construction was desirable. See E. A. Williams, *Federal Aid for Relief* (New York, 1939), p. 27, and Harry L. Hopkins, *Spending to Save* (New York, 1936), pp. 21–24.

[7] Harry Hopkins was later to make this ironical comment: "The situation was similar to that of a wealthy individual who assured a poor relation that he would keep in touch with him by telephone and correspondence . . . but that under no circumstances must he ask Uncle Sam for money. . . . President Hoover and his associates feared national responsibility more than they fear national unemployment." *Spending to Save,* pp. 44–45.

[8] The following statements illustrate the position taken by President Hoover in the middle of 1932: "I hold that the maintenance of the sense of individual and personal responsibility of men to their neighbors and the proper separation of the functions of the Federal and local Governments require the maintenance of the fundamental principle that the relief of distress rests upon the individuals, upon the communities and upon the states." *Congressional Record,* vol. 75, p. 11597.

". . . It is generally agreed that the balancing of the Federal Budget and unimpaired national credit is indispensable to the restoration of confidence and to the very start of economic recovery. . . . A public works program . . . through the issuance of Federal bonds, creates at once an enormous further deficit." *Ibid.,* p. 10959.

cure it. Obviously in this wordy warfare there was no meeting of minds. But, as depression dragged on, certain very practical issues undermined the traditional argument. The local and state responsibility for relief of which President Hoover spoke had meant, in times past, primarily a responsibility toward unemployables with only an occasional and transient responsibility toward employables. By 1932, however, the employables were the problem. Workers who had never before been a public responsibility were on relief. Thus precedent was no longer a safe guide for governments to follow, because unemployment was on a scale which had dislocated precedent.

Certain it was that the public had become unsympathetic to federal inaction. Many federal-aid bills were introduced into Congress, and on July 21, 1932, the Emergency Relief and Construction act became a law and the federal government was started along the road toward participation in the financing of relief.[9] This measure contained three features, the first of which was expansion by $322,224,000 of appropriations for public works. Of this sum $120,000,000 was to be "advanced" to the states for emergency construction of federal-aid highways with no limitation against use within the boundaries of municipalities and with no requirement of matching. It was, however, to be charged against the regular federal grants for highway construction, 1938–1947. (In fact, these deductions were not made because two years later the provision was withdrawn.) The remaining $202,224,000 was divided among a number of types of projects—public buildings outside the District of Columbia, river and harbor schemes, etc.[10] The second feature was that loans for self-liquidating projects (not to exceed $1,500,000,000) could be made by the Reconstruction Finance Corporation, not merely to the state governments, but to localities as well. This was an innovation which paved the way for establishment of direct

[9] An earlier start could be indicated, since in March 1932 the Federal Farm Board was authorized to give forty million bushels of surplus wheat to the Red Cross for distribution, and in July provision was made for distributing forty-five million bushels of wheat of the Grain Stabilization Corporation and five hundred thousands bales of cotton of the Cotton Stabilization Corporation. These steps, however, involved no direct relationship with or assistance to state and local governments.

[10] See J. Kerwin Williams, *Grants-in-aid under the Public Works Administration* (New York, 1939), pp. 24–25. President Hoover signed this bill, although he had, ten days earlier (July 11, 1932), vetoed a similar bill. *Congressional Record,* vol. 75, pp. 15040 f.

federal–local relationships, although immediately few loans were made.[11] The third feature was provision, through the Reconstruction Finance Corporation, for loans of $300,000,000 to the states for relief and relief work. An interest rate of 3 per cent was to be charged, and beginning in 1935 the loans were to be repaid by annual deductions from the federal grants for highway construction. These safeguards turned out, however, to be a false front,[12] because two years later Congress cancelled the requirement of deductions and converted the loans into gifts. Senator Wagner then asserted that "there was [in 1932] a very definite opinion among members of Congress . . . that the repayment would never take place. . . ."[13] Altogether $280,360,000 was distributed to forty-two states and two territories, $16,140,000 to a few counties, and $3,484,000 to a few cities.[14]

The faltering and evasive provisions of the Emergency Relief and Construction act of 1932 were important as a mirror of things to come. The traditional position had been undermined, and when in the spring of 1933 a new administration took office the debate about federal responsibility had no real life. Congress assumed a large but undefined responsibility for direct relief, work relief, and public works.[15] Postponing for the present any

[11] This power of the R.F.C. was terminated in 1933, and renewed in 1934 and in 1938. J. K. Williams, *Grants-in-aid*, p. 37, p. 41 n.

[12] President Hoover seems to have put his trust in them, and one is reminded of how, nearly a century earlier, President Jackson believed that the distribution of the surplus revenue was not a gift. Jackson declared that the states had "no more authority to receive and use these deposits without intending to return them than any other deposit bank or any individual temporarily charged with the safekeeping or application of public money would now have for converting the same to their private use . . ." (December 5, 1836). *Messages and Papers of the Presidents*, III, 239.

[13] E. A. Williams, *Federal Aid for Relief*, p. 48.

[14] *Municipal Year Book*, 1937, pp. 379–380. Six states—Connecticut, Massachusetts, Delaware, Nebraska, Vermont, Wyoming—did not take advantage of the act.

[15] See U.S., 72nd Congress, 2nd session, Hearings on S. 5125 before the Subcommittee of the Senate Committee on Manufactures. Very many of the ideas which went into the legislation of 1933 were presented at the hearings. Mr. Harry Hopkins appeared as a witness and he stated that for 1933, one billion dollars of public money was needed for purposes of direct relief and work relief, of which the federal government should supply one-half (p. 81); that the merits and possibilities of work relief should be explored (p. 83); that federal participation would not cause the states and localities to withdraw. "I am convinced that the Federal Government, with half a billion dollars a year, could get a similar amount from the cities, counties and states throughout this country. I think it is a matter of how the relief funds are administered" (p. 84).

discussion of the federal policy about public works, let us survey the experience with relief.[16]

Federal Emergency Relief Administration

The Federal Emergency Relief Administration, set up in May 1933, was designed to cope with the problem of relief. It found that in forty-two states, state relief organizations had been set up, but that in only six had they been in existence for as much as a year[17] and therefore an efficient organization had not been created. Yet no practical alternative to use of this state machinery seemed feasible. To set up a federal relief organization would cause intolerable delay; and the administrative wisdom of such a step was questionable, since administration of relief required decentralization, careful attention to detail, and local knowledge. The proper decision appeared to be to leave administration of relief in state and local hands, and to use FERA as an agency for the distribution and supervision of grants in aid.

But one very striking difference between these and other grants was the great discretionary power given to the federal administrator. The appropriation of $500,000,000 made in the original act of May 1933 was split into two equal parts, one portion to be distributed at the discretion of the administrator, and the other portion to be distributed so that each state would receive $1 as a grant for every $3 of state–local money spent for relief. After October 1, 1933, however, any unexpended balance of the latter appropriation might, with the approval of the president, be shifted over to the discretionary appropriation, and this in fact was done. In subsequent appropriations, which brought the total funds made available to FERA to $3,250,000,000, no requirement for state–local contributions was attached.

The justification for this unusual procedure has been stated succinctly by Mr. Hopkins: "If Congress had provided a fixed percentage of Federal aid, millions of people would have suf-

[16] The usual distinction between public works and work relief is that whereas in the former case the workers are not selected and the projects are not framed with relief directly in mind, in the latter case the workers are taken from the relief rolls and in selection of projects preference is given to those which permit a large use of labor organized on force account rather than on contract work.

[17] U.S., 74th Congress, 1st session, Senate Document No. 56, Expenditure of Funds, Federal Emergency Relief Administration, Exhibit U, p. 651.

fered."[18] FERA was launched without benefit of statistics and Congress did not know either the extent of the need or the fiscal abilities of the states. Moreover, states and localities were bound in varying degrees by constitutional and statutory provisions about borrowing, taxation, and expenditure. Self-imposed limitations had to be reckoned in calculation of fiscal ability, because removal of limitations was certain to be a slow business, whereas the impact of depression was here and now.

The federal administrator, in addition to his great power in allocating grants, had also wide powers of supervision. The act required that state applications for grants be made through the governors and accompanied by information concerning state relief needs and state practice in administering relief. Monthly reports of disbursements were also to be made by each state. These provisions were, in general, neither more nor less severe than those of many other federal aid statutes. What mattered was how the federal administrator was prepared to exercise his powers so as to protect federal funds, insure adequate minimum standards in provision of relief, and even give direction to the forms which relief should take. It turned out that Mr. Hopkins had definite intentions of exercising as close a control as possible and of pushing the states toward what, in his opinion, were adequate and sound relief policies.[19] State relief organizations, starting with the worst, were reviewed; suggestions were made for improvement in personnel, in records, and in control over local officers.[20] FERA had also a decided bias against direct relief and in favor of work relief, since the former was thought to be injurious to the morale and the skills of workers. This raised a major difficulty. In the spring of 1933 most states and localities favored direct relief. Work relief put a greater direct burden upon their treasuries, it required discovery and appraisal of suitable projects, and it raised serious questions of administration and supervision. The states and localities were, therefore, reluctant to turn to work relief, and for similar reasons they were unwilling to diversify their programs by making special provision

[18] *Spending to Save*, p. 99.

[19] "The federal relief officials were not satisfied with attempting to establish safeguards for the honest expenditure of federal money by the states; a further objective was to channel state and local spending in such a manner as to carry out definite social policies." E. A. Williams, *Federal Aid for Relief*, p. 150.

[20] U.S., 74th Congress, 1st session, Senate Document No. 56, pp. 652–53.

for particular classes of the unemployed—professional people, white collar workers, youth. As a result a feeling grew up at Washington in favor of a program of work relief which would be completely federal and which, by giving an example to the states and localities, might provide the foundations for a better and more comprehensive scheme.

There were other reasons why, late in 1933, a shift in tactics seemed desirable. The brisk boomlet of the summer had been followed by recession, and a fourth winter of unemployment lay ahead. PWA, despite great expectations, had been able to spend very little. Some people declared that a genuine shot in the arm might be provided by an extensive, but short-lived, program of direct federal spending.

Thus it was that in November 1933, with the greatest possible haste and the least possible advance preparation, the Civil Works Administration was set up to provide work relief under federal auspices and not through grants in aid. In less than a month over two million people were put on its rolls—most of them transferred from the work relief program of FERA—and at its peak, in mid-January 1934, it was employing 4,260,000 persons. Thereafter came an equally precipitous decline, and within three months CWA was at an end. It had spent approximately $1,000,000,000, of which 82½ per cent was federal money.

The friends of CWA have always claimed that, apart from providing work for millions of people during the winter of 1933–34, the program provided practical lessons for all levels of government. Work relief, stalled up to this time, was shown to be feasible; state officers, many of whom were temporarily taken into federal employment, received valuable training; the whole machinery of state and local relief got time to get organized. While none of these claims are false, there is another side to the shield. As a venture in pump-priming CWA was not a success. Because of haste, makeshift administration, and a questionable wage policy, wastes offset the gains. And the reluctance of states and localities to engage in work relief on a grant basis was not lessened; rather, CWA encouraged them to argue that work relief was a federal responsibility. When CWA was replaced by an emergency work-relief program of FERA on a grant basis, little state and local money was forthcoming, and the next step was establishment of the Works Progress Administration.

The grant technique had, meanwhile, shown other deficiencies. FERA required a considerable amount of information from state officers before making its allotments, and it developed a variety of supervisory practices.[21] Federal field agents were appointed to make inspections, a special division of investigation was set up to look into irregularities, and every effort was made to bring about improvement in state and local personnel. Indeed, the vigor of Mr. Hopkins in opposing political appointments astonished most observers, accustomed to the touchiness of the states.[22] At the outset the states were remarkably docile when confronted with federal "dictation," a response explained by their gratitude at having federal assistance in handling a job which had plagued them for several years. But the docility did not last. Friction arose over personnel, and over what were adequate standards of relief and of work; a sharp debate developed over the respective merits of relief and work relief; the states became jealous over the distribution of federal grants and impatient at the inability of Washington to understand local opinions (or prejudices); Washington became impatient because many states objected to the application of uniform rules and regulations.

When a serious dispute occurred, the federal administrator could, of course, use the basic power of withholding the grant. But even in administering the old-line grants this power had seldom been exercised, and obviously special obstacles hindered its use when the immediate sufferers would be the unemployed.[23] The federal administrator had, however, another weapon—federal assumption of relief in a state—and this was exercised on

[21] See E. A. Williams, *Federal Aid for Relief,* chap. iv; and also U.S., 74th Congress, 1st session, Senate Document No. 56, pp. vii–ix.

[22] E. A. Williams, *op. cit.*, pp. 157–158, reports the following colloquy at the Senate Hearings on the Emergency Relief appropriation bill for 1935:

"Senator McCarran: 'You select the personnel?'

"Mr. Hopkins: 'No; we approve the personnel.'

"Senator McCarran: 'You selected the personnel in my State.'

"Mr. Hopkins: 'Yes; for all practical purposes, I did.'

"Senator McCarran: 'By what authority did you do that, may I ask?'

"Mr. Hopkins: 'It is not a matter of authority. I did not appoint the administrator in the State. The Governor actually appointed the man. The Governor consulted me about who the man should be and you have one of the best men in the country out there on that.'

"Senator McCarran: 'Of course, I do not agree with that.' "

[23] Mr. Hopkins did, however, write vigorous letters to governors. See V. O. Key, *The Administration of Federal Grants to States* (Chicago, 1937), p. 351.

six occasions. The first instance occurred in February 1934, when Governor W. H. Murray of Oklahoma declared that he would not apply for relief grants unless allowed to spend them without regard to federal rules and regulations. "Federalization" followed and was maintained until, a year later, a new governor was elected who agreed to coöperate with FERA. On March 1, 1934, after the disclosure of clear evidence that employees of the state relief organization in North Dakota were being assessed for political purposes, federal control was instituted and maintained for nine months. The next federalization—that in Massachusetts in March 1934—applied only to work relief and it arose out of a technical difficulty. State statutes required distribution of grants to the localities on the basis of population, while FERA insisted that the distribution be according to need. A year later, in Ohio, federalization resulted after an acrimonious quarrel between Mr. Hopkins and state officials over the proper state contribution and after evidence was presented of corrupt political interference with relief. Finally, in April 1935, federalization took place in Georgia and Louisiana after much bickering over the low standards of relief and relief administration in these states.

Beyond question this is an astonishing record. In six sovereign states the federal government assumed direct responsibility for a function which, not long before, it had declared to be none of its business. Federalization did not, of course, mean that existing state and local officers were discharged; instead most of them were sworn in as federal officials. But the result was not happy. Washington had to make decisions upon petty local issues concerning which it had no information. Moreover, federalization reduced the financial contribution and the active coöperation of a state. Had it not been for the political stigma that was associated with federalization, poor states might have been tempted to dump the responsibility for relief upon federal shoulders; and it is possible that the passage of time might have taken the sting out of federalization and that its usefulness as a whip would have disappeared.

Consider next the summary figures of expenditure for emergency relief for the three years 1933–1935. Of the $4,100,000,000 provided from public sources (not including expenditure for CWA, PWA, WPA, CCC), the federal government provided

70.9 per cent, the states 12.8 per cent, and the localities 16.3 per cent; and over the period the federal share rose sharply. Moreover an average figure of 70.9 per cent conceals the wide range in the share which the federal government provided in different states, the extremes running from 39.3 per cent in Rhode Island to 98.0 per cent in South Carolina. When on June 14, 1933,

TABLE 18

DISTRIBUTION OF EXPENDITURES FOR EMERGENCY RELIEF, 1933–1935

	Federal	State	Local	Total
1933	60.6%	14.3%	25.1%	100.0%
1934	72.0	12.6	15.4	100.0
1935	74.4	12.3	13.3	100.0
Total	70.9	12.8	16.3	100.0

President Roosevelt addressed the governors and state relief administrators concerning the inauguration of the federal relief program, he said: "It is essential that the states and local governments do their fair share. They must not expect the Federal Government to finance more than a reasonable proportion of the total." [24] Does Table 19 indicate that this "essential" was achieved? Everyone is aware that the states differed in resources; that their relief problems differed; that their ability to contribute was partly a function of their past fiscal history and their constitutional impediments; that state sentiment toward the relief problem was not uniform; that the absence or presence of a sound welfare organization before 1933 was important; that some states, aware of the discretionary basis of the FERA, were inclined to hold back, knowing that at worst only federalization would result. How could these and many other circumstances be appraised so as to determine a fair pattern for the distribution of grants? Long-run and short-run, practical and abstract issues were interwoven, and an answer given on one basis would conflict with that given on another. For example, one might argue on long-run and abstract grounds that a state which had hamstrung itself by constitutional and statutory limitations upon its fiscal power should not, for this reason, be given larger grants than a

[24] U.S., 74th Congress, 1st session, Senate Document No. 56, p. x.

state which was free to exert its strongest fiscal effort; that a state which was in poor fiscal shape because of a dissolute past should not be favored over one which, because of prudence and foresight,

TABLE 19

PERCENTAGE OF TOTAL EXPENDITURE FOR EMERGENCY RELIEF FROM PUBLIC FUNDS ASSUMED BY THE FEDERAL GOVERNMENT IN THE STATES AND THE DISTRICT OF COLUMBIA, 1933–1935[a]

Percentage	Number of states	States
35.0–39.9	1	Rhode Island
40.0–44.9	3	Connecticut, Delaware, New Hampshire
45.0–49.9	0	
50.0–54.9	3	Maine, Massachusetts, New York
55.0–59.9	2	Iowa, Vermont
60.0–64.9	1	Indiana
65.0–69.9	2	California, New Jersey
70.0–74.9	5	District of Columbia, Kansas, Maryland, Pennsylvania, Wisconsin
75.0–79.9	9	Illinois, Michigan, Minnesota, Missouri, Nebraska, Ohio, Oregon, Texas, Utah
80.0–84.9	5	Arizona, Colorado, Idaho, North Dakota, Washington
85.0–89.9	6	Kentucky, Montana, Nevada, Oklahoma, South Dakota, West Virginia
90.0–94.9	5	Alabama, Georgia, Tennessee, Virginia, Wyoming
95.0–99.9	7	Arkansas, Florida, Louisiana, Mississippi, New Mexico, North Carolina, South Carolina

[a] Derived from *Municipal Year Book*, 1937, p. 408.

was in sound condition; that a state which neglected to establish an adequate welfare organization should not, on this account, receive special treatment. Yet a federal administration had to think of the unemployed, and it had, therefore, to give grants on a basis which would be indefensible in more normal circumstances.

There were, of course, some objective criteria by which state and local fiscal ability could be estimated; and in the fall of 1934, FERA, dissatisfied with the contributions of the states and localities, made a detailed survey for the purpose of bringing pressure upon the delinquent. Description of the technique would not be profitable [25] because it had as a basis chiefly the pragmatic conviction that the federal government was being imposed upon in many states. What is important is that this drive obtained insignificant

[25] See U.S., 74th Congress, 1st session, Senate Document No. 56, pp. xi–xiv.

results. The sharpest criticism from Washington was not an adequate spur, because "poker-minded state officials," [26] not too concerned about relief standards, could outbluff a federal welfare agency concerned primarily with the unemployed and only secondarily with equity in the allocation of federal grants among the states. The national interest did not permit that the unemployed in a state should suffer even if the state dodged assumption of its share.

It is, therefore, apparent that the discretionary power given to the federal administrator concerning allocation of grants was inevitable, but that it tended, as time passed, to undermine administration of relief. In 1933 there was no discernible pattern of grants which would suit the situation, and the federal administrator in succeeding years was never able to find a satisfactory pattern. He was exposed to political currents and pressures which made impossible any equitable distribution between the federal government and each of the states. Some states received more, some less, than their fair share; some states were reasonable, others were shamelessly importunate. By 1935 it was clear that the attempt of FERA to determine the amount of the state contribution by administrative discretion was a failure.[27]

Works Progress Administration [28]

A new federal program was announced to Congress by the president on January 4, 1935. Of the five million cases on the relief rolls, a major distinction was to be drawn between the employables and the unemployables. In the latter group were some one and a half million persons who, so the president declared, "in the days before the great depression, were cared for by local efforts—by states, by counties, by towns, by cities, by churches and by private welfare agencies. It is my thought that in the future they must be cared for as they were before." [29] To this general statement there was, however, a significant qualifica-

[26] E. A. Williams, *Federal Aid for Relief*, p. 171.

[27] Cf. Key, *Administration of Federal Grants to States*, p. 351. "The experience of F.E.R.A. in attempting to fix the amount of the state contribution by administrative discretion indicates that whenever feasible the matching requirement should be fixed by statute rather than by administrative discretion."

[28] It became the Work Projects Administration in 1939.

[29] *Congressional Record*, vol. 75, p. 117.

tion. Legislation was to be proposed—it became the Social Security act—which would give federal assistance in providing for certain *categories* of unemployables—the aged poor, dependent children, the blind, etc. Otherwise, unemployables were to become a state–local responsibility.[30] "The Federal Government," said the president, "must and shall quit this business of relief."

To care for employables a new federal agency, the Works Progress Administration, was to be created. It was to provide work relief, not through the device of grants, but as a federal scheme modeled upon the earlier CWA. Behind it lay the breakdown of federal–state coöperation in FERA, and the intense conviction of key federal officers both that a work-relief program was preferable to direct relief and that such a program should be federally administered in its entirety. Mr. Hopkins testified to a Senate Committee as follows:

> On the question of a work program as against direct relief, it is my conviction, and one of the strongest convictions I hold, that the Federal Government should never return to a direct relief program. It is degrading to the individual; it destroys morale and self-respect; it results in no increase of the wealth of the community; it tends to destroy the ability of the individual to perform useful work in the future; and it tends to establish a permanent body of dependents. We should do away with direct relief for the unemployed in the United States. Under a system of grants-in-aid it is difficult to insist upon definite standards. If someone steals your money, you can, of course, withdraw Federal funds, but the result of that is that the unemployed in the state are the only ones who really suffer by this action.[31]

There were, however, many critics of the new policy. Professional social workers, interested in and conscious of the need for direct relief, declared that withdrawal of the federal government would halt the administrative progress made in this field and would, besides, cause many state governments to throw the burden of direct relief back on the localities.[32] Social workers had

[30] FERA was liquidated gradually because in many states an abrupt transition was not feasible.

[31] U.S., 75th Congress, 3rd session, Senate Hearings, Special Committee to Investigate Unemployment and Relief, pp. 1348–50.

[32] "When the President of the United States announced withdrawal by the Federal Government he set a precedent quickly followed by states and in some cases by local governments. The theory that relief is entirely a local problem is, of course, one that state legislators can learn as well as Congressmen and Senators." Grace Abbott, in *This Business of Relief,* p. 24.

A social worker from Alabama said: "Social consciousness in Alabama has been

not the same confidence in a work-relief program as had Mr. Hopkins. A program of public works, divorced from relief and recruiting its workers according to their fitness for the particular jobs in hand, met with their approval. But a program which combined work and relief might, in their opinion, be "neither good work nor effective relief." [33] It would have to develop projects around the skills which the unemployed happened to possess, and this meant that for many classes of people no satisfactory projects could be developed. The social workers, instead of WPA, wanted a genuine public works program, together with federal participation in a scheme of direct relief by grants in aid.[34]

Needless to say, these suggestions were coldly received at Washington. Mr. Hopkins and his friends wanted a centralized scheme with no state responsibility for a policy; they condemned direct relief and insisted that improvement was an impossible task. Mr. Aubrey Williams, then deputy administrator of WPA, went even farther and insisted that behind the drive for direct relief were "subversive forces" which aimed at destruction of all other types of assistance.[35]

WPA was set up, therefore, to operate as a federal program by spending federal money directly through its own officers. Projects were planned and proposed, that is, "sponsored," to it by any type of governmental unit from the road district up to the state. The sponsor submitted a description of the project and detailed estimates of cost and labor requirements. After consideration WPA accepted or rejected. If the project was accepted, an effort was made to put most of the responsibility for supervision upon

lifted by the bootstraps since the inauguration of FERA. This has been done with little help from the state. We can rather depend upon the state to follow the lead of a higher governmental unit. . . . Without the leadership of the federal government progress in establishing a sound relief program will be made but slowly." *Ibid.*, p. 68.

[33] *Ibid.*, p. 167.

[34] *Ibid.*, pp. 165–69. The grants were to be made up of "basic grants" fixed upon some simple factor such as population, and equalization grants which would be allocated and supervised by a federal board.

[35] ". . . I plead with you to believe that when you ask for a federal direct relief program, you are playing with subversive forces so powerful that the result will be the dilution and then the demolition of the work program. You will get three million and a half people on direct relief and nothing else." *This Business of Relief*, p. 137.

the sponsor. Projects were diverse in type,[36] but construction expenditures dominated—amounting to 76.5 per cent of the total to June 30, 1940—with expenditure for highways, roads, and streets being the most important. The aim was to give employment. At least 90 per cent of the workers had to be certified as in need of relief by local or state agencies.

The wage policy of WPA was the center of much controversy, but only a brief explanation can be made here. From July 1936 to June 1939, WPA workers were given a "security wage," which meant that they received the prevailing rate of pay for work of a similar nature in a region, but only for a period long enough to earn the monthly security wage. For unskilled workers this monthly wage ran "from $21 per month in the rural South, to $60.50 in the larger northern cities. The rates for intermediate, skilled and professional and technical workers [were] higher, the maximum being $103.40 for professional and technical workers in the larger northern cities."[37] The result was that a worker could earn his security wage by working on WPA for a portion

[36] Expenditures by WPA and sponsors on projects operated by WPA, cumulative through year ending June 30, 1940, in millions of dollars:

Projects	(1) WPA funds	(2) Sponsor funds	(1) + (2)	Percentage of total
Highways, roads, streets	2,932	795	3,727	38.9
Public buildings	768	231	999	10.4
Recreational facilities	743	112	855	8.9
Sewer systems, etc	757	208	965	10.1
Airports	151	49	200	2.1
Conservation	326	52	379	4.0
Sanitation	161	41	201	2.1
Total construction	5,838	1,488	7,326	76.5
Community service	513	83	596	6.2
Research and records	356	57	413	4.3
Sewing	587	46	633	6.6
Welfare	255	57	313	3.3
Other	98	7	105	1.1
Total professional service	1,809	251	2,060	21.5
Miscellaneous	138	54	192	2.0
Total	7,785	1,793	9,578	100.0

[37] U.S., 75th Congress, 3rd session, Senate, Preliminary Report of a Special Committee to Investigate Unemployment and Relief, p. 50.

of a month. For instance, in the District of Columbia, a carpenter on a WPA project could earn "his security wage of $73.50 by working 42 hours in a month at the established prevailing rate of $1.75 per hour." [38] Inevitably many workers took other employment in their spare time, thus defeating the original intention of Congress. In June 1939 Congress changed this system.[39] Workers on WPA were to work approximately 130 hours a month for their security wage, that is, they were put on a sort of salary. The administrator, Colonel Harrington (who replaced Mr. Hopkins in December 1939), testified that the shift had greatly improved the efficiency of projects [40] both because administration was simplified and because the workers, instead of working varying periods running from 50 to 140 hours per month, now worked 130 hours.

Let us turn next to an issue which is of more significance in a study of federalism: the division of costs of projects between the sponsor and the federal government. The sponsor contribution was, until 1939, left entirely to the discretionary power of the administrator, who could and did endorse projects to which sponsor contributions were widely different. Indeed, the acceptability of a project to WPA was initially determined by considerations of a very different nature. The first duty which WPA put up to its officers in the different states was to provide employment for a specified number of the unemployed. WPA would pay their wages and provide also a variable sum ($5–$7) per man for materials. Thus the vital issue for the WPA officer was to determine the number of men to be employed in a given area over a period of time, since this would enable calculation of the amount of federal money necessary to pay wages and provide materials. Only at this stage was there serious negotiation about the amount of the sponsor's contributions; and the issue most in the mind of the federal officer was likely to be, not the relative financial ability of the different sponsors, but the fact that the larger the contribution the more people could be put to work. Inevitably a great diversity in contributions developed, and this diversity,

[38] *Ibid.,* p. 7.

[39] The shift was back approximately to the scheme of the original act of 1935.

[40] U.S., 76th Congress, 3rd session, Senate Hearings before the Committee on Appropriations, Emergency Relief Appropriation Act, 1941, pp. 62–63.

while of no great concern to Mr. Hopkins, was very disturbing to Congress.

Mr. Hopkins always maintained a complete and unreserved skepticism about the general problem of determining the financial ability of a governmental unit. "I have," he told a Senate Committee, "employed the best men in the United States to determine the capacity of cities to pay. . . . I have made hundreds of investigations of the ability of cities to pay and the share they were capable of paying; and in the last analysis it is a matter of opinion."[41] Holding this conviction, he was naturally "opposed to any matching formula of any kind at any time."[42] And his suspicion of measurement of financial ability rested also upon a dislike of forcing his staff to "become financial police officers all over America."[43]

Let us look at actual figures of sponsor contributions when these are grouped by states (with separate figures for New York City and Hawaii). The following table shows a range with Pennsylvania and New York City at one extreme providing less than 11 per cent, and Tennessee at the other extreme providing over 34 per cent. Even more startling figures had been uncovered for a shorter period. Thus Senator Byrnes was shocked to discover that of $483,800,000 spent by WPA in New York City through December 31, 1936, the sponsor contributed only $2,240,000, or 0.5 per cent, while sponsors in South Carolina had contributed 23.6 per cent.[44] The excuses made by the federal administrator were quite unconvincing. Certainly nobody felt that a strictly uniform contribution regardless of the type of project, the conditions of employment, the financial ability of a sponsor, was justi-

[41] U.S., 75th Congress, 1st session, Senate Hearings before the Committee on Appropriations, Emergency Relief Appropriation, p. 322.

[42] *Ibid.*, p. 320.

[43] *Ibid.*, p. 322.

[44] *Ibid.*, p. 263. A defense made by Mr. Hopkins and Mayor La Guardia was that New York City spent heavily for direct and categorical relief, and that its heavy burdens there excused its smaller sponsor contributions to WPA. Many states and localities, according to Mr. Hopkins, robbed their direct relief funds in order to put up contributions. But surely WPA is to be condemned for condoning this practice, especially in view of the known predilections of the administrator for work relief. WPA was not supposed to allow a variation in sponsor contributions according to its appraisal of how a community was handling the whole job of relief administration. It had no adequate comparative knowledge of how this job was being done, and to permit a variation in the light of particular information was an abuse of discretionary power.

TABLE 20

SPONSOR CONTRIBUTIONS BY STATES AND OTHER UNITS AS PERCENTAGE OF TOTAL WPA EXPENDITURE, CUMULATIVE THROUGH JUNE 30, 1938[a]

Percentage	Number of units	States and other units
9.0–10.9	2	New York City, Pennsylvania
11.0–12.9	1	Delaware
13.0–14.9	8	District of Columbia, Indiana, Maryland, Massachusetts, Maine, Ohio, Washington and West Virginia
15.0–16.9	8	California, Illinois, Minnesota, Montana, New Jersey, New Mexico, South Dakota and Wisconsin
17.0–18.9	9	Arkansas, Colorado, Connecticut, Georgia, Louisiana, Michigan, North Dakota, Oregon and Rhode Island
19.0–20.9	6	Florida, Kansas, Kentucky, Maine, New Hampshire and Virginia
21.0–22.9	5	Alabama, Nebraska, New York, Oklahoma and South Carolina
23.0–24.9	4	Iowa, North Carolina, Texas and Vermont
25.0–26.9	3	Arizona, Mississippi and Utah
27.0–28.9	4	Idaho, Nevada, Wyoming and Hawaii
29.0–30.9	0	
31.0–32.9	0	
33.0–34.9	1	Tennessee
Total	51	

[a] U.S., 76th Congress, 3rd session, House Hearing before the Subcommittee on Appropriations, Work Relief for the Fiscal Year 1941, pp. 468–69.

fiable. But the actual variation could not be explained in these terms—indeed it often seemed to violate them—and Congress was convinced that the root of the matter was the very broad discretionary power given to the administrator. That had subjected him to pressures and had put upon him an impossible task. Some sponsors had been able to shirk and it appears that often the well-to-do governmental units were more successful at evading their responsibilities than were the poor.[45]

The impatience of Congress at the great variation in sponsor

[45] An eminent social worker, Miss Edith Abbott, has described the results as follows: ". . . We know that Harry Hopkins looked at the formulas and went serenely on his way distributing his funds by a kind of super-guesswork process. The states that were successful in 'playing poor' asked—and got—more than they should have had, and others asked—and needed—as much, but got less. The truth is, of course, that some states are *unable*—and others are *unwilling*—to carry the load." "Unemployment Relief a Federal Responsibility," *Social Science Review*, September 1940, p. 449.

contributions was aggravated also by the feeling that the sponsors *as a whole* were pushing too much of the cost of projects upon the federal government. The projects were of direct benefit to the local governments and states, and the fact that WPA, unlike FERA, was a federal organization did not carry with it the conclusion that most of the cost should be federal. As economic conditions improved, the federal administrator did put pressure upon sponsors to increase their contributions, and these rose from 10.0 per cent of the total in the fiscal year ending June 30, 1936 to 21.4 per cent in 1938, with a decline to 19.3 per cent in 1939.[46] But Congress was still dissatisfied and it was also determined to limit the discretionary authority of the administrator.[47] The unwisdom of requiring a uniform contribution *per project,* without regard to type or to the fiscal situation of the sponsor, was admitted. Congress thought it would be fair, however, to require a uniform average contribution *per state;* and in 1939 it declared that after January 1, 1940, not less than 25 per cent of the total cost of all non-federal projects approved to be undertaken in any state was to be borne by the sponsors.[48] The willingness of a

[46] Expenditure on WPA projects by source of funds, 1936–1940, in millions of dollars:

Year ending June 30	Total	WPA funds	Sponsors' funds	
			Amount	Percentage
		(*millions of dollars*)		
1936	1,326	1,194	133	10.0
1937	2,052	1,751	301	14.7
1938	1,735	1,364	372	21.4
1939	2,562	2,068	494	19.3
1940	1,903	1,409	494	26.0

Source: Federal Works Agency, *Report on the Progress of the WPA Program,* June 30, 1940, p. 58.

[47] Some people declared that even apart from the actual results, the authority of the administrator should be restricted. Thus Senator Vandenburg said: "My feeling is that regardless of the good faith of the Relief Administrator . . . it is utterly contrary to the theory and spirit and genius of our republican institutions that an authority so vast in respect to the distribution of public funds should rest in a relatively subordinate administrative officer." *Congressional Record,* vol. 30, part 2, p. 1228.

[48] Mr. Hopkins had earlier objected to this scheme (see U.S., 75th Congress, 1st session, Senate Hearings before the Committee on Appropriations, Emergency Relief Appropriation, p. 330). The Byrnes Committee (U.S., 76th Congress, 1st session, Senate Report 2 from the Special Committee to Investigate Unemployment and Relief) suggested a different scheme which is of interest because it made the sponsor contribution diminish in states where the average per capita income was low. A minority report by Senator Davis criticized this plan.

sponsor to put up 25 per cent or more of the cost did not, of course, automatically make a project acceptable, and did not determine the distribution of the total of WPA funds among the states over any period of time. Such a scheme would have favored the richer areas and it would have failed to relate the distribution of an appropriation to the amount of unemployment. From the outset, WPA had made some effort to spend in relation to unemployment, and after March 1939 it developed fairly satisfactory figures which were used as the most important determinant of the distribution of WPA money.[49] Sponsors had, however, to come forward with proper projects and contributions before expenditures could be made.

No real difficulty arose out of the restrictions upon the discretionary power of the federal administrator which Congress imposed in 1939. Indeed, the new administrator, Colonel F. C. Harrington (appointed in December 1939) did not wish to have complete power to pass upon sponsor contributions because he would then "have forty-eight delegations a day to deal with." Colonel Harrington declared also that, when a community had to make a significant sponsor contribution, it was more inclined to select the project with care. When a poor community simply could not put up 25 per cent, then other more wealthy communities had to contribute more than 25 per cent, and these latter had sometimes been disposed to look upon the 25 per cent provision as a minimum rather than as average requirement. But this difficulty was not serious.[50]

Table 21 shows the per capita federal expenditures of WPA by states (cumulative through June 30, 1940) and the rank of each state in terms of average per capita income, 1938–1940. Nobody would expect work-relief expenditure, designed to meet

[49] WPA took account of the unemployment and the population of a state and from these it determined 80 per cent of the average number of persons authorized to be employed in a state during a month. The remaining 20 per cent of the state quota was settled according to the recommendations of the regional directors of WPA. See U.S., 76th Congress, 3rd session, Senate Hearings before the Committee on Appropriations, Emergency Relief Appropriation Act for the Fiscal Year 1941, p. 91.

[50] Nor was there much trouble about averaging up within a state the varying contributions made according to the *type* of project. The next administrator, Mr. H. O. Hunter, pointed out some objections to the 25 per cent requirement and asked for its removal (U.S., 77th Congress, 1st session, House Hearings, Appropriations Committee, Work Relief and Relief for the Fiscal Year 1942, p. 15).

TABLE 21

PER CAPITA AMOUNT OF WPA EXPENDITURE, EXCLUDING SPONSORS' FUNDS, ON PROJECTS OPERATED BY WPA, BY STATES. CUMULATIVE THROUGH JUNE 30, 1940

Per capita	Number of states	State and rank in per capita income, 1938–1940
$ 5.00–14.99	1	Texas (33)
15.00–24.99	2	Virginia (32), North Carolina (42)
25.00–34.99	6	Maryland (9), Maine (24), Tennessee (43), Delaware (1), Iowa (30), Georgia (44)
35.00–44.99	7	Mississippi (48), Alabama (46), Vermont (23), South Carolina (45), Kentucky (41), Louisiana (38), Arkansas (47)
45.00–54.99	8	Florida (39), Connecticut (4), New Hampshire (18), Oregon (16), Wyoming (11), Kansas (34), Idaho (28), Oklahoma (39)
55.00–64.99	12	Arizona (26), Nebraska (31), Nevada (1), Missouri (25), California (6), Washington (13), Rhode Island (8), Wisconsin (20), West Virginia (35), New Mexico (40), Utah (27), Michigan (14)
65.00–74.99	4	New Jersey (2), Indiana (21), Minnesota (22), North Dakota (37)
75.00–84.99	5	New York (3), Pennsylvania (15), Illinois (10), South Dakota (36), Colorado (19)
85.00–94.99	3	Massachusetts (7), Ohio (12), Montana (17)
	48	

unemployment, to be distributed uniformly among the states, because the incidence of unemployment is certain to be more severe in some areas than in others. Nor would one expect to find a significant relationship between unemployment and per capita income of the states. Nevertheless the table is startling, both because of the wide variation in the actual federal work-relief expenditure among the states and because of the evidence that, in broad terms, the expenditure was lighter in the states which rank low in per capita income. In the upper half of the table are to be found sixteen states which are below the median per capita income; in the lower half are to be found only eight states which are below the median. Do the figures indicate that, if sponsor contributions were abolished and provision of work-relief made entirely a federal responsibility, the expenditure would involve this sort of inter-regional transfer? Would it be better, in financing work-relief, to retain sponsor contributions, but, as the special Senate committee to investigate unemployment and

work-relief [51] suggested, to have them vary inversely with per capita income of the states?

Let us turn next to another feature of WPA which is of some importance in a study of federalism. A minimum of 90 per cent of the workers on WPA had to be certified as of relief status, and in spite of the fact that WPA was run directly by federal officers, certification of workers was almost always left to the public welfare agencies of the states and localities. A very wide variation, therefore, prevailed in the accuracy with which this task was performed. The welfare agencies in some localities referred practically all needy unemployed persons to WPA, while in others they waited until vacancies occurred in the WPA program. Evidence exists that some people were or were not referred to WPA because of their political affiliations. These known defects caused Colonel Harrington to recommend in 1940—a recommendation not accepted by Congress—that WPA be permitted to spend a small sum ($5,000,000) to assist the states in securing a reasonably uniform level of certification standards, a more adequate determination of the need and eligibility of applicants, and a more prompt and simple administration.[52] The business of getting the right people on the relief rolls was, he declared, "one of the biggest problems that is left in W.P.A." Congress, however, did not respond.[53]

The defense program and then the war altered the outlook for WPA. As rapidly as possible it shifted its emphasis to projects

[51] The Byrnes Committee.

[52] The following dialogue will indicate the problem:

"Senator Russell. The basic reason for this recommendation, as I understand it, is to get some uniformity of investigation and certification in all the states?

"Colonel Harrington. Correct.

"Senator Russell. As it is now, one state will have one method and another will have practically no machinery at all, and will delay certification, others certify everyone who applies, and you want to use this to give you authority to really impose on the states a uniform system of certification?

"Colonel Harrington. That is right.

"Senator McKellar. Not only that, but one of the important things is that only worthy people should be put on.

"Colonel Harrington. Yes, sir. It attacks one of the biggest problems that is left in W.P.A., the business of getting the right people on to the rolls."

U.S., 76th Congress, 3rd session, Senate Hearings before the Committee on Appropriations, Emergency Relief Appropriation Act for 1941, p. 127.

[53] WPA from 1939 on did not put full reliance upon certification by state and local agencies. In some states it made its own investigation and certification despite the lack of any statutory authority.

connected with military needs,[54] the total number of persons on its rolls declined, and the question of its complete elimination became pertinent. Work relief at a time when the nation was desperately short of manpower seemed to be unnecessary and even incongruous.

CONCLUSION

The sharp reversal in the condition of the labor market and the consequent abolition of WPA provide an opportunity to reshape the governmental provision which may be made for the relief and alleviation of unemployment. In the years 1933–1942 the nation tried out a variety of programs. During the first two years, 1933–1934, the federal government used grants in aid both of direct relief and work relief, and it also through CWA provided work relief as a completely federal program.

Then in 1935 the president announced a new plan which was intended to demarcate with some precision the responsibility which the federal government, as contrasted with the states and localities, was prepared to assume. A broad distinction was drawn between employables and unemployables, with a parallel distinction in terms of governmental responsibility. Provision for unemployables was to be a state–local task, handled through direct relief without federal assistance. Provision for employables was to be a federal task, handled chiefly through work relief.

As the foregoing pages show, these lines of demarcation were never clearly drawn. In the practical operation of the programs, 1935–1942, an overlapping of federal–state–local responsibilities occurred to such an extent as to suggest that proper principles for handling the problems of relief and unemployment had not been formulated.

The three broad types of governmental programs which have been used in dealing with relief and unemployment are direct relief, work relief, and public works. Primary responsibility for any one of those can be federal, or it can be state–local. Before 1933 the prevailing philosophy had held that they should be state–local, although lip-service was paid to the proposition that, with respect to public works, federal grants in aid were justifiable.

[54] In such projects statutory limitations concerning hours of work, earnings, federal non-labor costs, and sponsor contributions were lifted.

The Roosevelt administration had no theoretical qualms about the utilization of public works on the traditional basis of federal grants, but it turned away from such a program as too slow and too small in the circumstances confronting the nation. After brief experiment with a grant-in-aid program for direct relief and work relief, it attempted on the one hand to withdraw entirely from direct relief, and on the other to take over complete responsibility for work relief.

Now it must be emphasized that, except as a makeshift and for purposes of pump-priming, work relief is defective either as a substitute for public works *or* for direct relief. Work relief—WPA—operates through a means test, which may mean that a worker is reduced to destitution before he can be taken on the rolls. It involves also improvisation of projects and an artificial fitting of the available workers to them, because adequate projects to utilize the skills of the unemployed workers who are available can seldom be developed. The outcome may be that people are forced to work "on substandard projects and for substandard wages." [55] Public works have, of course, the defect that they provide work only for a small segment of the unemployed; and relief has the defect that it is a dole. The demoralizing effect of receipt of direct relief must, however, be weighed against the demoralization which comes from make-work. It follows from these generalizations that an adequate national plan of action should rest, as far as possible, upon a coördinated public-works scheme, and what such a scheme should be will be examined later. But since such a scheme is not likely to be adequate, it must be supplemented by direct relief and by work relief. Should direct relief be left in state–local hands, or should the federal government bear a share by giving grants in aid? Should work relief be a federal responsibility, or should this program also be a grant-in-aid program with the grants handled preferably through state governments?

During the period of FERA, federal grants encouraged the states to make considerable progress in the provision and administration of direct relief. After 1935 much of the ground which had been gained was lost. The states not seldom threw back upon the localities the responsibility for direct relief, and there

[55] C. M. Bookman, "The Essentials of an Adequate Relief Program," *Proceedings of the National Conference on Social Work*, 1940, p. 167.

was, in some measure, a retreat to the old poor laws.[56] Relief standards became lowest in those areas where the need was greatest. In 1940 the amount paid per inhabitant for general relief was $3.07 for the nation as a whole, and under $0.20 in the following eight states at the bottom of the scale: [57]

Mississippi	$0.02
Alabama	0.10
Tennessee	0.10
South Carolina	0.12
North Carolina	0.12
Arkansas	0.14
New Mexico	0.14
Georgia	0.16

Circumstances of this sort have raised doubts concerning the wisdom of complete federal withdrawal from direct relief in 1935, and it is urged that the federal government establish a system of grants for general relief for "all needy applicants regardless of the causes of their need." [58] Special categories of unemployables are already in receipt of federal aid, and extension to cover persons outside these categories would involve no new principle and little new machinery.

Against such a step it can be urged—and this was in the minds of President Roosevelt and his advisors in 1935—that responsibility for this function should be state and local, because only the state and local governments can administer with success a program which affects destitute unemployables. This basic proposition must be admitted. What can be stated, however, is that this does not debar federal participation. Grants in aid are sufficiently flexible to permit reconciliation of both federal and state–local responsibilities. The federal government is interested only in seeing that the program as set up provides a national *minimum* of relief, and, as will be argued more fully later, this minimum should be low enough so that it can reasonably be reached even by the poorest states. The error which exists in the present old-age assistance program, by which the federal grant is at a level

[56] Arthur P. Niles, "Relief in Illinois without Federal Aid," *Social Service Review*, June 1940, pp. 283–300.

[57] *Social Security Bulletin*, March 1941, p. 39.

[58] National Resources Planning Board, *Security, Work, and Relief Policies* (Washington, 1942), p. 493.

which can only be reached by the rich states, should not be repeated. The conditions which should be attached to federal grants for general direct relief require expert consideration—and this has not yet been provided—but at the very least they should include establishment of statewide plans, state financial participation and supervision, adequate reports, and the merit system in administration.[59]

What should be the division of governmental responsibility for work relief? Should the federal government in some future depression recreate a counterpart of WPA, or should it as an alternative stand prepared to give grants in aid for work-relief projects initiated by state–local governments?

An expression of preference for the second alternative should not be construed as an intent to do away altogether with work relief.[60] One may believe that the American people have a strong bias toward work relief as compared to the dole, and yet feel that distinct limits exist to the effectiveness and equity of a large program of work relief. And one may believe that a work-relief program resting upon the stimulus of federal grants is superior to a similar program controlled by the federal government on the model of WPA. Much of the past criticism of WPA has been wide of the mark. No organization in our peacetime history ever handled such large funds with so little corruption and political favoritism. It provided the nation, moreover, with buildings, highways, airfields, etc., which have been and will be of genuine service. These issues are not here in dispute. What is asserted is that a different framework of work relief would serve the nation better for the future, and that the job which WPA had a part in doing is not one which can best be handled as a federal responsibility.

The actual history of WPA indicates that a practical overlapping of federal–state–local responsibilities occurred. Sponsor contributions were one manifestation, and the whole tangle which ensued argues that a formal arrangement, such as grants, would have been preferable. Important administrative tasks had to be

[59] The cost of such a system would, of course, depend on details not outlined here. But probably an acceptable scheme would not cost the federal government more than $300,000,000 annually.

[60] For such a charge levied at the critics of WPA see *Congressional Record*, vol. 83, pp. 7230–35; U.S., 75th Congress, 3rd session, Senate Hearings, Special Committee to Investigate Unemployment and Relief, pp. 433–38; 1319–29.

placed in state–local hands without any orderly and prior planning. The need for haste may be an acceptable excuse for 1935–36; it should not be acceptable for the future. The states and localities did not hesitate to push unemployables upon WPA, thereby breaking across the areas of responsibility which President Roosevelt had delineated as federal. The fact is that work relief, as well as direct relief, calls for detailed supervision—casework—and this characteristic should remove it from the federal administrative sphere. Federal effort should be devoted to encouraging state–local initiative and coöperation through grants in aid. The grants should be variable over the period of the business cycle so that, for example, the federal share would be markedly enlarged in bad years as compared with good years; and in good years special federal effort should be devoted to insuring that the machinery is put in order and plans are made against emergencies to come. And finally, a long-run plan should look toward a system by which local projects are channeled through a state agency, although at the outset federal–local grants might have to be condoned.[61]

[61] Certain of the great metropolitan areas might, even in a long-run plan, be given direct access to federal grants.

CHAPTER VIII

PUBLIC WORKS ADMINISTRATION

> Successful public works policy calls on the one hand for long-period continuous planning, and on the other for swift and decisive action. It does appear that in this country [Great Britain] at any rate the machinery for either is very inadequate. Is it conceivable, however, that it might be developed? [1]

PROBABLY NO SCHEME for alleviation of the business cycle has a longer history or a wider support than that of making the volume of public works expenditure inverse to general cyclical swings in economic activity. Mr. Hoover, when Secretary of Commerce, endorsed this plan,[2] but nothing of consequence was done. Yet when depression struck in 1929 the federal government turned first to expansion of its own program of public works and through the President's Employment Committee, headed by Colonel Arthur Woods, it encouraged state and local governments to follow its example, although without offering them financial assistance. The President's Committee on Unemployment Relief, headed by Mr. Gifford, which superseded the Woods Committee in the summer of 1931, was, however, unwilling to see any further expansion of the federal program and it frowned upon the proposal of federal aid.

Congress received this sort of fiscal conservatism with growing impatience, and in July 1932, as has already been described,[3] it provided $322,224,000 for further expansion of federal works expenditure, and it authorized the R.F.C. to make loans for self-liquidating projects, both public and private, and to loan $300,000,000 to the states for relief and relief work. This measure paved the way for the much more extensive program of the Roosevelt administration of which an important part was to be an enlarged expenditure for public works. On May 17, 1933,

[1] Ursula K. Hicks, *The Finance of British Government, 1920–1936* (London 1938), p. 229.

[2] Arthur D. Gayer, *Public Works in Prosperity and Depression* (New York, 1935), p. 11.

[3] Supra, 139.

the president told Congress that "a careful survey" had convinced him that approximately $3,300,000,000 could be "invested in useful and necessary public construction," [4] federal and non-federal. In less than a month legislation which made provision for this program was passed.

FRAMEWORK OF PWA

The Federal Emergency Administration of Public Works (PWA) was aimed at promoting recovery and not merely at provision of unemployment relief. Part of its program, especially in the early years, consisted in construction of federal works, but the part of most importance for this study is the non-federal program by which PWA endeavored to stimulate state and local construction by grants and loans.[5] The original act permitted grants as a maximum to be 30 per cent of the cost of labor and materials used in a project (which amounted to 20–25 per cent of total cost), but in 1935 the maximum grant was made 45 per cent of the total cost of a project. Actually the grants given were the maximum, although there was inconclusive discussion of the proposition that grants be variable according to some criterion of the social desirability of a project.[6] PWA also was authorized to deal with local as well as state governments, in this following the precedent set by the Emergency Relief and Construction Act of 1932, but departing from almost all earlier precedent. The traditional federal–state relationship was overridden because of the emergency. The bulk of public works which might be stimulated by federal grants (and loans) was the responsibility of local governments, and most of the states had no department or bureau connected with or informed about these works. To operate the program solely through the state govern-

[4] The nature of the survey and details of the estimate were not disclosed. Senator Wagner had earlier introduced a bill proposing an appropriation of $3,000,000,000. According to a story told by Mr. Ickes, the senator in a noisy and crowded committee room asked his secretary if this included $300,000,000 for New York projects. The affirmative answer was misunderstood and the total amount was therefore boosted to $3,300,000,000. See Harold L. Ickes, *Back to Work* (New York, 1935), p. 14.

[5] PWA also made loans to private industry, but this activity, as well as its housing program, will not be described here. See J. F. Isakoff, *The Public Works Administration* (Urbana, 1938), pp. 127–35.

[6] J. Kerwin Williams, *Grants-in-aid under the Public Works Administration* (New York, 1939), pp. 119–120.

ments would therefore mean delay or even complete inaction. The fact that loans, as well as grants, were to be employed, strengthened the desirability of direct federal–local contacts,[7] because no substitute for direct appraisal of the credit of an applicant by PWA was available.

Since PWA was to operate on the basis of projects, it was natural that the law should contain no formula which specified the total of the allotments for any state. PWA itself considered the use of possible formulae based upon population, area, unemployment, etc., because of a feeling that, unless limits were set, the wealthy states would draw to them a disproportionate amount of the grants. But none of the formulae seemed adequate, and although PWA gave some attention to geographical distribution, curtailing or expanding its allotments when it appeared that some areas were getting more or less than their fair "quota," it usually met any charges that some states were getting more than their share by the argument that figures of expenditure for public works by states only reflected "direct benefits." No matter where the actual expenditures were made, advantages accrued to the nation. In the words of the administrator, Mr. Ickes, "the main benefit flowing from [PWA] is the stimulus to the heavy industries. If Pennsylvania, New York, Illinois, and Ohio, as a result of this program have an opportunity to start mills going rolling steel, making brick and making cement, it does not make any difference to those States where those materials are put into a structure." [8] This was politically an effective answer, and it has, of course, some economic justification. But one should remember that PWA did not initiate application for grants. The amount of applications and where they came from depended on the initiative of localities and states, which in turn depended upon many factors, such as their fiscal condition and available projects.

[7] *Ibid.*, p. 49.

[8] U.S., 75th Congress, 3rd session, House Hearings before the Subcommittee of the Committee on Appropriations, Emergency Relief Appropriation Act of 1938 and Public Works Administration Appropriation Act of 1939, p. 434. Mr. Ickes went on to give figures of the money going for materials and supplies to the states east of the Mississippi River for the Grand Coulee Dam. The highly speculative nature of any computation which distributes direct and indirect benefits by states is obvious.

WHY SPENDING WAS SLOW

When PWA was set up in 1933 many people expected that through it a great deal would promptly be done to relieve unemployment. But while the desirability of prompt action was obvious, many circumstances pulled in the opposite direction. To go at an unfamiliar job with haste would lead not only to wasteful expenditure; it might also encourage political jobbery. The administration of local and state public works in the United States had not been lily-white, and the opportunity to spend money which came from the federal treasury might stimulate predatory interests. Obviously it was the task of the federal administrator to weigh these conflicting considerations, and it happened that Mr. Ickes had very strong convictions about the importance of suppressing graft in the spending of public money. As a result, speed was sacrificed to caution and the organization built up in 1933 was centralized at Washington. "Too great emphasis cannot be laid upon the point that very little autonomy or discretionary power was entrusted to the state officers of the P.W.A. Mimeographed instructions from Washington descended in a daily flood. The orders of the central office extended not only to policy matters but also to the minutiae of office procedure. . . . If circumstances arose which required the interpretation of a minor federal rule, even the P.W.A. man in the field 2,000 miles from Washington could not assume authority to settle the matter, though the necessity for swift action might be apparent." [9] For this reason few men were put to work by PWA and its expenditure remained at a low level.[10] Unquestionably the rapid expansion of PWA was held back by obstacles which the most headlong administrator could not have overcome,[11] but in addition the

[9] J. Kerwin Williams, *Grants-in-aid,* pp. 79–80.

[10] PWA expenditure (grants) on non-federal projects was as follows (in millions of dollars):

	January–June	July–December
1933	—	1.8
1934	13.1	35.0
1935	32.6	48.3
1936	113.4	152.1
1937	105.5	94.5

[11] Most serious were the constitutional and statutory limitations on the appropriation of money and the incurring of debt. See *Congressional Record,* vol. 81, pp. 5872–75.

program was retarded by centralization, and as a result Congress and the president turned first to CWA and then to WPA as more supple instruments.

In 1935, however, PWA was reorganized in the hope of making it a more effective spender. The new policy at Washington made work relief the spearhead of the attack upon unemployment, and PWA was instructed to give a preference to relief labor. For a time the number of relief workers on the non-federal projects of PWA rose, but it soon dwindled and PWA did not become a work-relief agency.[12] In 1935 also an attempt was made to stimulate state and local spending for public works by raising the maximum grant from 30 per cent of the cost of labor and materials in a project to 45 per cent of the cost of a project. This amounted to a doubling of the grant, and it did encourage the submission of projects. Creation of WPA, however, provided a competitor of PWA, despite efforts to delimit the jurisdiction of each. On July 1, 1935, a statement was issued according to which WPA was to undertake small and useful projects costing less than $25,000, while PWA was to handle applications for large projects. This arbitrary division proved neither satisfactory nor workable. Localities which could get WPA to accept their projects naturally went to it, since this meant federal assumption of a very large percentage of the cost, whereas under PWA a locality had to provide 55 per cent. The requirement that, under WPA, at least 90 per cent of the labor force be drawn from the relief rolls, did, to be sure, debar acceptance of some heavy construction projects, but undoubtedly WPA cut into applications which otherwise would have come to PWA.[13]

The supervision which PWA exercised over its grants was probably more detailed and vigorous than that of any other federal grant agency. There were, as has been noticed, special reasons for this—the newness of the job, the absence of suitable administrative machinery, and the unsavory past reputation of public-

[12] J. Kerwin Williams, *Grants-in-aid*, p. 182. In 1937 another effort was made to stimulate more use of relief labor by a regulation which made the federal grant 115 per cent of the wages paid to workers drawn from the relief rolls, although not in excess of 45 per cent of the cost of the project. It also was ineffective.

[13] The Byrnes committee said, "When local officials can go to two different departments to secure approval of projects, they can have two different stories. When they must go to one department, there can be but one story." U.S., 76th Congress, 1st session, Report 2 of the Special Senate Committee to Investigate Unemployment and Relief, January 14, 1939, p. 5.

works expenditure. PWA therefore required applicants for grants (and loans) to submit detailed information about their projects, and this information was examined with critical care.[14] After approval of an application, PWA would make an advance grant—5–10 per cent on the 1933 basis, 15–25 per cent after 1935[15]—followed by "progress payments" as the work went forward. The device of progress payments gave PWA a chance to check upon the work and to see that none of the conditions which had been specified were being infringed. This aggressive policy encountered no important opposition—an indication that, if the will is there, a federal agency can insist that its conditions be observed.

PWA and Loans

A most unusual feature of PWA was its loan policy. The loans were made at the flat rate of interest of 4 per cent,[16] first on the basis of "reasonable," and after 1935 on the basis of "acceptable," security. The practical tests which PWA applied to determine what was "reasonable" or "acceptable" differed from those applied by private lenders principally in that immediate liquidity of the loan was not stressed and that ultimate improvement in the fiscal situation of a borrower was presumed. PWA was also, it appears, much more willing than private lenders to forgive a questionable past financial history. These differences in attitude stem from the fact that PWA was supposed to aid recovery and that its success would be measured by its contribution to this end, whereas private lenders have no such responsibility. The criteria which a private lender applies in depression are, indeed, certain to be *more*

[14] The experience of PWA indicated that many localities and states often did not have, and did not know how to prepare, important information concerning the financial, legal, and engineering aspects of a project. This indicates that no scheme for use of public works expenditure as a cyclical device has a chance of success without careful training of state and local officers in advance. Desirable projects may exist which cannot be accepted by the federal agency because of the deficiency of information concerning them.

[15] Isakoff, *The Public Works Administration*, p. 93.

[16] Besides safeguarding federal money, PWA has been accused with some justice of tying conditions to its grants which had other motives, e.g., lowering of power rates. (J. Kerwin Williams, *Grants-in-aid*, pp. 155–58.) The wage rates set by PWA were also much in dispute, and there is no doubt that PWA sometimes set its scale higher than the prevailing level in areas in which it thought this level too low. PWA consistently followed a liberal policy toward organized labor, partly because the construction industry was strongly unionized and partly because of friendships.

severe than in time of prosperity because liquidity becomes to him a matter of much greater importance. PWA did not have to worry about liquidity; it could, instead, plan to hold its assets until the economic situation had improved.

The opportunity of borrowing from PWA was not at first widely exercised. Here again part of the fault lay in the meticulous, complicated, and overcentralized administrative procedure of PWA, but more especially in the constitutional and statutory limitations which hindered the borrowing of states and localities. To be sure, one section of the 1938 act which created PWA seemed, on a literal reading, to override all limitations by providing that "the President, in his discretion and under such terms as he may prescribe, may extend any of the benefits of this Title [Title II of NIRA] to any State, county, or municipality notwithstanding any constitutional or legal restriction or limitation on the right or power of such State, county or municipality to borrow money or incur indebtedness." [17] But instead of using this dubious power, PWA attempted to discover methods by which the limitations might be circumvented. One plan, much considered in 1933 but little used, was for PWA to construct projects and then lease them, with provision for installment purchase, to state and local bodies.[18] Another plan, which illustrates the extremes to which legislative and judicial sophistry may go, was the issue of "insurrection" or "public danger" bonds by several states. Many state constitutions, while imposing limitations upon borrowing, provide that bonds may be issued to meet certain public dangers. Nothing can be more sure than that the dangers of depression were not present in the minds of the framers of this exception, yet in 1933 the State of Washington issued bonds "to suppress an insurrection" and this was upheld by the supreme court of the state.[19] Other and much more reasonable devices for getting around debt limitations were the issue of special assessment bonds and tax anticipation warrants. The former are a liability of the property benefited by the improvement; the latter, so long as the taxes to meet them have actually been levied, create no new indebtedness. But all of these schemes were of minor importance. What

[17] J. Kerwin Williams, *Grants-in-aid,* pp. 228–29.

[18] Isakoff, *The Public Works Administration,* pp. 97–98; J. Kerwin Williams, *Grants-in-aid,* pp. 233–34. The possibility of removal of the limitations by state and local action was not overlooked, and to some extent it took place.

[19] J. Kerwin Williams, *op. cit.,* p. 246.

counted in enabling states and localities to extend their borrowing was use of revenue bonds, issued directly by them or by an "authority." In an examination of intergovernmental relations this is important enough to merit a fuller explanation.

The activity of PWA here stemmed from the obvious block which constitutional and statutory limitations were putting upon its program. Its early grants covered 20–25 per cent of the cost of a project, but many states and localities were unable to raise the remainder by taxation and unable also, because of a thicket of restrictions, to borrow from the federal government. In December 1934, President Roosevelt called to the attention of every governor the difficulty which had been experienced in "gearing the legal machinery which has served municipalities in your State adequately for decades to the speed with which the Federal Government must extend credit to achieve the desired results" (through a public works program).[20] Revision of this machinery was desirable, and he offered the assistance of the legal division of PWA "for the purpose of suggesting bills which, if enacted into law, would enable municipalities . . . to secure the benefits of this phase of the recovery program." The assistance was widely accepted, and it was of great importance in stimulating revenue bond laws and the creation of "authorities."

A revenue bond, as distinct from a general obligation bond, is secured by the revenue from the governmental project which it helps to create. Since such a bond does not put a burden upon the ordinary revenues of the state or local government, it has been held to be outside debt limitations. Here, then, was a device which PWA decided to encourage. Whereas in 1931 only fifteen states permitted municipalities to create revenue bonds, by 1936 the number had grown to forty.[21] PWA made numerous loans secured by revenue bonds, and the type of project so financed expanded in a surprising way. Besides the more usual projects such as toll bridges, utilities for the supply of electricity, water, etc., there were those also for golf courses, swimming pools, college dormitories, etc. How can these latter be self-supporting? One must remember that the debt which they carry does not represent their total cost. Before 1935 an outright grant of federal money covered 20–25 per cent, and after 1935, 45 per cent, of the

[20] J. K. Williams, *Grants-in-aid*, p. 249.
[21] John F. Fowler, *Revenue Bonds* (New York, 1938), p. 55.

cost. Not more than the remaining portion has to be supported by the revenue from the project. The record of PWA with revenue bonds is as follows: As of October 31, 1939, some $758,-200,000 had been purchased by it, but only $71,800,000 were in its possession. To the Reconstruction Finance Corporation $656,900,000 had been sold; $10,000,000 had been transferred to the United States Housing Authority; some had matured or been called, and a few had been sold directly. Of the $758,-200,000 handled by it, the defaults of principal had been $2,400,000 and of interest $2,300,000 on October 31, 1939. Some borrowers had been disposed to regard the loans as gifts, but many of the defaults represented projects which had not had time to develop their earning capacity. The broad picture thus was that PWA as an agency had emerged from its ventures in borrowing with relatively small losses and that it had disposed of most of its holdings.

This is not to say that the creditors now holding the bonds may not have losses, or that the revenue bond has proved itself as a fiscal device. Some sophisticated persons declare that the revenue bond is a lazy solution of a difficult problem; that it is the answer to the question: When is a debt not a debt? Undoubtedly the revenue bond after 1933 was given an artificial stimulus because it offered an escape from debt limitations. If authorities have been created which do not prove to be self-supporting the revenue bond will be in disrepute, and states and localities may be forced to come to the rescue, thereby placing burdens upon their general revenues.[22]

After 1935, PWA led a precarious existence, with extension of its life at two-year intervals in 1937 and 1939. In 1935 Congress began to move away from a public-works and toward a work-relief program, although PWA was authorized to use as grants the money received from its "revolving fund," that is, from sales of securities which it held.[23] The recession of 1937 brought a

[22] The revenue bond and the public corporation do, however, carry several important advantages, and it seems certain that they have permanent places to fill in the economic system. See L. S. Knappen, *Revenue Bonds and the Investor* (New York, 1939). B. U. Ratchford, *American State Debts* (Durham, N.C., 1941), chap. xxi, gives a more pessimistic appraisal.

[23] For a summary of the appropriations made under the various statutes, and of the yearly expenditures, see U.S., 76th Congress, 3rd session, House Hearings before the Subcommittee of the Committee on Appropriations, Independent Offices Bill for 1941, Part 2, p. 1420, pp. 1434–36.

temporary expansion in the spending program of PWA which reached a peak of $100,000,000 a month in the summer of 1939. Thereafter there was a sharp decline, and June 30, 1941, was set as the date at which PWA was to go out of existence. After January 1939, no new allotments were made and the process of liquidation went rapidly forward.[24]

Consolidation of Public Works Activities

It must be remembered that at no time did PWA ever handle all the public-works activities of the federal government. Other agencies handled some construction of projects which were purely federal, and they also gave assistance through grants to non-federal projects. The Public Buildings Branch of the United States Treasury Procurement Division is an example of the former; the Bureau of Public Roads is an example of the latter; and WPA, entirely a federal agency, nevertheless secured part of its expenditure from local and state governments. It has often been argued that, as a step toward cyclical planning of public works, the federal government should place all—or nearly all—of its constructional activities in a single agency, and on July 1,

[24] Total construction expenditures of PWA (in millions of dollars):

	To June 30, 1941	On June 30, 1941 (incomplete)
Federal	1,877.7	95.9
Non-federal	4,144.2	425.9
Total	6,021.9	521.8

Distribution among major types of projects to June 30, 1941:

Type of project	Millions of dollars
Buildings	2,216.8
Sewage and water systems	794.9
Streets and highways	910.1
Heavy engineering structures	453.4
Flood control, water power and reclamation	426.1
Vessels	268.6
Railroads	201.0
Electric power (excluding water power)	101.6
Aviation	52.5
Other	596.9
Total	6,021.9

Source: Second Annual Report, Federal Works Agency (Washington, 1942), p. 314, p. 321.

1939, a step was taken in this direction when PWA, WPA, the Bureau of Public Roads, the Public Buildings Branch of the United States Treasury Procurement Division, the United States Housing Authority, and the Branch of Building Management of the National Park Service, were gathered into the new Federal Works Agency. Critics have declared that this sort of move cannot be expected to bring advantages in economy or efficiency,[25] since the activities of the agency will have to be divided according to their distinctive fields and since most federal construction is done on private contract. So far as the technical and administrative tasks are concerned, these objections may be valid, but they miss an important point. What is desired by those who advocate coördinated planning and execution of public works is that responsibility for timing be more centralized, so that when a decision is made to expand or retard, it can be carried out. The proper decision here requires economic, and not administrative or engineering, knowledge; the advantages are those which would come from diminishing the amplitude of cyclical swings in general economic conditions.

Public–Private Construction—1930–1940

With the depression in 1930, the area of public as compared with private construction greatly expanded, and within the area of public construction the federal share grew at an exceptional pace. As Table 22 shows, in 1930 public expenditure—federal, state, and local—was approximately 32 per cent of total new construction in the United States, and of this total, federal expenditure was less than 4 per cent. A marked change had taken place by 1935, when public construction was 54 per cent of total new construction, and of this federal was 36 per cent. State and local construction by 1935 not only was a smaller part of total construction than in 1930, but it had shrunk in absolute amount by more than three-quarters. This shrinkage was one factor clearly inimical to a proper counter-cyclical use of expenditure for public works. Despite a vast increase in federal expenditure, total public expenditure for new construction fell off because of a decline in state–local expenditure. If this is to be a regular result, then

[25] U.S., 75th Congress, 1st session, Senate, Report to the Select Committee to Investigate the Executive Agencies of the Government, No. 14, p. 45.

TABLE 22

PUBLIC AND PRIVATE CONSTRUCTION: 1930–1940

	Public Construction				
	Financed by federal funds	Financed by state and local funds	Total	Expenditures for private construction	Total[a]
		(millions of dollars)			
1930	307	2,469	2,776	5,941	8,717
1935	1,234	616	1,850	1,605	3,455
1939	2,206	1,313	3,520	3,491	7,011
1940	2,281	1,143	3,424	3,985	7,409
		(per cent)			
1930	3.4	28.4	31.8	68.2	100
1935	35.6	17.9	53.5	46.5	100
1939	31.5	18.6	50.3	49.7	100
1940	30.8	15.4	46.2	53.8	100

[a] National Resources Planning Board, *Development of Resources and Stabilization of Employment in the U.S., January 1941* (Washington, 1941), Part I, p. 17.

the practical applicability of the counter-cyclical theory is limited, since in depression federal expenditure can hardly be swelled enough to offset this double decline. But if techniques can be framed which will expand state–local expenditure along with federal, then the counter-cyclical scheme may have a wider usefulness.

ELEMENTS OF A COÖRDINATED PUBLIC WORKS SCHEME

The leadership and initiative in framing a public-works policy for all levels of government must come from the federal government. It alone has the fiscal resources; it alone can take an over-all view; and upon it, rather than any other level of government, falls the responsibility of moderating cyclical swings. Broadly put, three methods can be used by it to increase expenditure for public works in depression.[26] First, the federal government can expand the amount and area of its own projects. This area was greatly enlarged in the decade after 1930, and probably the limit has not been reached. By creation of WPA the federal government had an agency which undertook works once regarded as state and local responsibilities. Second, the federal government can use the grant technique to stimulate state–local construction as

[26] No attention is given here to methods by which the federal government can stimulate private construction, since the aim is to examine only intergovernmental relations.

has been done by PWA and PRA. Third, it can use loans to the states and localities, as was done by PWA.[27]

In order to appreciate the possibilities, it is essential to understand that expansion of public-works spending in depression should be financed by creation of debt. Obviously the federal government can easily take care that its expenditure for its own public works and also the grants which it makes to other governments are so provided. A difficulty arises, however, about the part of the expenditure provided by the states and localities. If the federal grant is, for example, 40 per cent of the cost of a project, the state or locality may secure the remaining 60 per cent by taxation of consumption. To secure it by loan may be impossible because of statutory restrictions, or the difficulty of getting reasonable terms, or inhibitions against borrowing in depression. Yet in this case the net effect on the whole economy of the grant scheme might actually be income-decreasing. It would seem that in depression, as a condition to payment of a grant for public works, the federal government should require that the state and local governments borrow the remainder; and since borrowing by them may be expensive or even impossible, the federal government should stand ready to provide loans, along with grants, to the state and local governments. In short, if we assume that, in depression, deficit financing of public works on a national basis is desirable, a scheme is indicated in which grants are conditioned by the requirement of supplementary loans and in which loans are made available by the federal government.

Little analysis is necessary to indicate why people with capital to lend are unlikely to support flotations of loans by local, and even by state, governments in depression.[28] A private lender can-

[27] Federal expenditures, grants, loans for new public construction were as follows, 1939–40 (in millions of dollars):

	1939	1940
Federal public works (excluding defense)	475	510
Federal grants	1,919	1,308
Federal loans	223	438
	2,617	2,256

Derived from *Development of Resources and Stabilization of Employment in the U.S., January 1941,* Appendix.

[28] National Resources Committee, *Public Works Planning* (Washington: G.P.O., 1936), pp. 156–57. See also the Report of the Urbanism Committee, *Our Cities: Their Role in the National Economy* (Washington, 1937), pp. 80–82.

not easily appreciate the merits of depression borrowing by local governments for pump-priming purposes, because the normal criteria which he must use in appraising requests for loans are not directly pertinent. Moreover, the responsibility for doing something about cyclical swings is a governmental and not a private function, and the private lender should not be expected to lend when the risk of loss is abnormal. This responsibility, besides, belongs primarily to the federal government, and when it tries a plan, such as pump-priming, it should do everything possible to make this plan work on a coördinated national scale. Local governments cannot by themselves do much deficit financing except at inordinate interest rates. Thus the Bond Buyers index of municipal bond prices stood, in the spring of 1933, at a yield of 5.7 per cent and the index of eleven "first-grade" cities at 4.9 per cent.[29] The spread between the yields of bonds of the federal and local governments is much wider in depression than in prosperity, because lenders are looking for safety and liquidity. The saving in interest which can be achieved through loans from the federal government is, therefore, at a maximum in depression. In the United States there are, indeed, constitutional barriers against state and local borrowing which would hinder the success of any coördinated fiscal scheme. But the record seems to indicate that states unfettered by constitutional restriction did no more borrowing in 1931–1935 than the rest,[30] an indication that economic rather than legal factors were decisive. The states and localities did not borrow extensively because to do so was too expensive or too heterodox. And it must be remembered that some private institutions which normally buy the bonds of subordinate governments are deterred from purchase in depression because, even when the bonds are safe, they may not be liquid, and liquidity is a quality which financial institutions cannot sacrifice.

The tests which the agency of the federal government should use in appraising the loans requested from it constitute a difficult problem. Some of those used by PWA seem suggestive. Thus marketability of the securities of a local government in the near

[29] *Municipal Year Book,* 1937, p. 467. The *Congressional Record,* vol. 81, pp. 5810–11, has a list of the yields and prices of certain state and municipal bonds, December 1933 and 1936.

[30] See H. J. Bitterman, *State and Federal Grants-in-Aid* (Chicago, 1938), pp. 150–53.

future was not applied as a test, the prospect of eventual resale to private investors at a fair price being used as a substitute. A believer in a coördinated plan of public works would argue that the dangers of losses to the lending agency because of overlenient appraisal are not to be taken very seriously. If bonds are accepted from a few local governmental units which ultimately prove to be too poor or too overburdened to carry them, then some loss could well be assumed as a cost necessary for the success of the scheme. The loss should, of course, arise out of fiscal, not out of political circumstances; default for political reasons would bring about utter demoralization of the plan.

If the propositions mentioned above are indicated for depression, converse propositions are indicated for recovery. In good years grants for public works should be eliminated, or at very least made on less generous terms. Any grants which are made should be financed from taxation, and conditions should be attached which would encourage the state and local governments to provide their share of the expenditure from taxation. The business of intergovernmental lending would diminish, so far as new loans are concerned. But of course all borrowing by state and local governments cannot be concentrated in depression, and there is much to be said for maintaining borrowing contacts between the federal agency and the state and local governments because of the importance of integrating and harmonizing all governmental loan policies over the whole of the business cycle. If in prosperity the agency sold its assets (the securities of state and local governments) to private investors, some of the proceeds might be reloaned, while the rest would be used to retire its own debts. Liquidation in good times of assets purchased in depression is part of a cyclical scheme.

It is entirely clear that this abstract scheme does not conform to past practice, and that conformity in the future will not be easy. Probably the most serious defect of grants as a countercyclical device is their inflexibility. For example, grants in aid of highways—and they are an important part of total grants—are authorized two years in advance, and the states make commitments on this basis. To expand the grants and commitments by supplementary authorizations is possible; to contract them promptly is very difficult. And many of the federal grants for public works have been made in order to stimulate the states

and localities into undertakings which appear to be desirable wholly apart from business conditions. Certain it is also that some projects, once started, have to be carried through to completion even in the face of prosperous conditions of general business. A scheme of power development, a large-scale irrigation project, cannot be checked midway to take account of cyclical factors. In short, political commitments and procedures, as well as limitations inherent in certain types of projects, are obstacles to the effectiveness of a public-works scheme.

That some of these obstacles can be reduced by "advance planning" and that advance planning in all its phases is essential has been a generalization of economists for decades. The experience of PWA served, however, to give precision to the notion, and the National Resources Planning Board was created to provide a "reservoir of public construction projects of tested value." Many writers have noticed also that a coördinated public-works plan requires removal of state and local barriers to borrowing. This thicket of constitutional and statutory barriers has as yet hardly been thinned. So long as a majority of voters are convinced that prudence in state–local borrowing can best be assured by restricting state–local borrowing power, just so long will a countercyclical scheme be hampered.

Aside from these practical and political difficulties, a debate has been waged over the relative merits of federal grants for public works, as compared with direct federal intervention. WPA is, of course, the prototype of the latter, and PWA of the former. It was, indeed, the defects of PWA and FERA after 1933 which brought WPA into being. PWA did not seem able to spend its appropriations; protracted negotiations between federal and state–local officials were necessary at every stage; in these negotiations, particularly over FERA money, sharp differences of opinion arose as to what was desirable. At best, a grant system allows federal officers merely to specify conditions; it does not give them primary responsibility. When a deadlock exists on any issue, nobody has the authority to break it with despatch by a final decision. Federal officers in 1933–1935 became utterly impatient with this division of authority; they requested and they were given the power to carry through all sorts of public works as federal responsibilities.

Yet the operation of WPA in a public-works scheme had de-

fects. While it offered a more prompt way of spending public money in depression, it presented great obstacles to curtailment after recovery. WPA was supposed to provide work relief for employables, and yet a considerable number of unemployables were put on its payrolls. Conceding that work relief is to be preferred to direct relief as a method of handling employables, it does not follow that it is preferable for unemployables. And even when a work-relief program is restricted to employables, it encounters special difficulties in a period of recovery. The task of providing projects which fit the skills possessed by unemployed workers is never easy, and it is aggravated in recovery both because the best workers move to private employment and because the total of the unemployed shrinks. It may be doubted that Congress will tolerate a work-relief scheme in a period of prosperity.

Another debatable question concerns the use of federal–local versus federal–state contacts. Direct federal–local contacts once seemed inconsistent with federalism, but in 1933, as an emergency step and in order to get things done, grants began to be made on a project basis to whatever type of governmental unit made requests. The justification was very clear and, looking to the future, the federal government should regard the precedent as established. Yet in setting up a public-works scheme the federal government should attempt to deal with the states, always provided that the states themselves take steps to set up adequate machinery within their boundaries to plan and execute it. That this can be done the history of the Bureau of Public Roads (now the Public Roads Administration) has demonstrated. Successful decentralization of the whole job of public-works planning by splitting it up among the forty-eight units of government which comprise our federal structure would be a forward step. Unfortunately some states are bound to be slow in coöperating, and in such cases the method of direct federal–local contact should be utilized. And direct contacts should be instituted also as the regular practice with respect to the great metropolitan centers such as New York City. In these cases there is an *imperium in imperio*. The metropolitan center has problems peculiar to it and not likely to be fully appreciated by a state legislature; and sometimes an upstate versus down-state, or city versus country, division exists which hinders cool consideration of the problems.

The great advantage of working through the states in a grant scheme is that decentralization is secured which should lead to coördinated action on a national scale. When the federal government goes directly to the localities, a jam at Washington is bound to result. Even when regional offices are set up in an effort to secure decentralization this expedient is unlikely to be as satisfactory as decentralization on a state basis because the states are the political units which have constitutional control over the localities and which are most likely to appreciate local problems. To attempt to shortcut, because of the tangles which must be straightened out before a coördinated federal–state–local scheme is possible, is to fail to secure the coöperation of important governmental units.

Another question has to do with the basis for the distribution of the federal grants. PWA, at the outset, was guided by no better rule than "first come, first served." If acceptable projects were offered, it was not the practice to refuse them on the ground that this city or state already had its share. In 1933–34 this practice was defensible because projects were scarce and more federal funds were available than could be employed. But in a well-planned scheme this should not happen, and some better method of distribution would be required. The suggestion of the special Senate committee to investigate unemployment and relief (The Byrnes Committee) that allotment to the states be made according to population and unemployment seems reasonable.[31]

Even if WPA or something like it is to be used as an instrument to increase expenditure for public works in depression, many types of state and local works will remain outside its orbit. These will be financed primarily from state and local funds, and the likelihood is that expenditure on them will expand inversely to what is required for counter-cyclical purposes, and therefore in such a way as to neutralize any purely federal scheme. But the federal government can extend its influence over this expenditure by the use of grants and loans in such a way as to secure coordinated national action. And while in the best of circumstances public works cannot be expected to remove cyclical swings, no scheme offers greater prospects of achievement with less modification of our governmental machinery and mode of life.

[31] U.S., 76th Congress, 1st session, Senate Report No. 2, p. 4.

CHAPTER IX

PUBLIC ROADS

By these operations [expenditure of the surplus revenue for objects of public improvements, such as roads and canals] new channels of communication will be opened between the States, the lines of separation will disappear, their interest will be identified, and their union cemented by new and indissoluble ties.

THOMAS JEFFERSON.

PROBABLY the responsibility for no major governmental function has gone through such a complete cycle of change as highways. More than a century ago the federal government, after active participation in construction for several decades, retired from the field, and not long afterwards so also did most of the state governments. The task of building and maintaining highways became, in the main, a local function. Shortly before the turn of the century a swing started in the other direction when the states began to interest themselves in a highway program, and soon Congress was debating what steps it should take. In recent decades the states have taken over complete responsibility for many main highways, and the federal government has developed an extensive program of grants in aid. The force of these trends is not yet spent.

BEGINNINGS

The first moderately good roads in the United States were private and not public. Toward the close of the eighteenth century chartered companies built turnpikes in those parts of the country where the revenue from tolls seemed to promise a profit. But sparse settlement limited their mileage and the temper of the people, in any case, was against monopolies. In a period usually characterized as laissez faire, the question began to be asked: Why should not government, and especially the national government, do something to improve internal transportation? The most obvious step was to use the public domain for this purpose. In 1802, when Ohio was admitted as a state, provision was made for applying 5 per cent of the proceeds from the sale of public

lands in the state to construction of roads connecting the eastern rivers with the Ohio, and a year later 2 per cent of the 5 per cent was assigned for roads outside the state. When other western states were admitted, this precedent was followed. But Jefferson soon was prepared to go farther. In his sixth annual message (December 2, 1806), he declared that better methods of communication would cause "the lines of separation" between the states to disappear and serve to cement the union "by new and indissoluble ties." [1] Meanwhile, Gallatin also had enlarged his views both as to the wisdom of federal construction of internal improvements and as to the ability of the treasury to finance them, and he proposed the relatively large expenditure of $20,000,000. The principal outcome of this flurry of interest was the Cumberland road, constructed by federal money and ultimately turned over to the states. The war of 1812, while it demonstrated the need of internal improvements, temporarily impaired the strength of the federal treasury, and in addition new doubts intruded about the constitutional power of the federal government. Madison insisted upon the necessity of maintaining "adequate landmarks" between federal and state duties, and with the election of Andrew Jackson the swing against enlargement of the federal responsibility for internal improvements was decisive. A fatal paralysis crept over Congress in the decades before the Civil War because of the widespread conviction that, if the federal government did as little as possible, dissension within the union would cease.

But when, after the Civil War, the issue of constitutionality was no longer a barrier, interest in federal assistance to road construction did not soon revive. The reason was the rise of the railways. They became the means of interstate transportation and their construction became a concern both of the federal government and of the states. Roads, however, seemed more clearly than ever before to be a local responsibility because traffic on them was local; they had, for the time, lost all the attributes which would make them a matter of national responsibility.

The slow revival of a broader interest in roads can be traced to a set of circumstances which at first seemed trivial. The railways, looking for traffic, wanted the construction of roads as feed-

[1] He felt, however, that the most desirable method to proceed would be enlargement of the federal powers by constitutional amendment.

ers, and they encouraged a "good roads" movement by propaganda and by financial support. The phenomenal rise of the bicycle in the 1880's also created popular interest. In 1891 New Jersey started a plan of state grants in aid for road construction which was widely copied by other states; [2] and Massachusetts in 1893–94 also gave a lead by beginning construction of state highways. It was, of course, the automobile which, by revolutionizing our system of transport, also revolutionized the responsibilities of governments toward highways. Beginnings were slow. In 1904 "state highway expenditures, directly or through grants in aid, amounted to $2,607,000, or 3.3 per cent of the total; in 1914 to $49,286,000, or 20.0 per cent." [3] The increase was appreciable, yet state participation on a vast scale was retarded until it was discovered that the new method of transportation provided new methods of finance. In 1904 revenues from motor registration were insignificant, and in 1914 they were only $12,882,000.[4] The gasoline tax had yet to be invented and borrowing for construction had been started in only a very few states.

Revival of Federal Interest

Meanwhile, Congress had gingerly shown some interest in the "good roads" issue. In 1893 an "Office of Road Inquiry" was created in the Department of Agriculture, with an appropriation of $10,000 to obtain and spread information. The appropriation was slowly increased and in 1912 amounted to $160,720.[5] By this time agitation for more extensive federal participation was under way, since no less than sixty-two bills for the purpose were introduced into Congress in 1912,[6] and a keen difference of opinion had arisen as to the proper direction for federal action. Some there were who insisted upon federal construction of a system of interstate highways, fifty thousand miles in extent. The proponents of this scheme argued "that forty-eight states constructing forty-eight kinds of roads in forty-eight different and uncorrelated directions cannot build any comprehensive and related

[2] H. J. Bitterman, *State and Federal Grants-in-Aid* (Chicago, 1938), p. 220.

[3] *Ibid.*, p. 100.

[4] *Ibid.*, p. 99.

[5] W. S. Holt, *Bureau of Public Roads* (Baltimore, 1923), p. 13.

[6] P. H. Douglas, "The Development of a System of Federal Grants-in-Aid," *Political Science Quarterly*, 1920, p. 263.

system of highways covering the whole country,"[7] and that federal grants in aid would mean divided authority and waste of funds. In this group were engineers and those who stressed the military value of highways. The other group, which ultimately had its way, preferred the more pedestrian plan of federal grants in aid, but with many differences of opinion as to the purposes and conditions to be attached. Should federal aid go for construction of interstate roads, or to local roads which would aid the marketing of local products? How much supervision should the federal authorities exercise? As was to be expected, the advocates of grants for local roads and of light federal controls were in the majority.[8]

In 1916 a federal aid road act was passed,[9] appropriating $5,-000,000 for 1916–17, and adding each year for five years an additional $5,000,000—a total of $75,000,000—to be distributed among the states for the construction of rural post roads on a matching basis. The distributive formula in this act was to have a long vogue: one-third was to be allocated according to relative population, one-third according to relative area, and one-third according to the relative mileage of rural delivery and star routes in a state. Provision was made for federal approval and supervision of the projects, and the federal regulations as drawn called for the creation of a department of highways in each state. This marked the beginning of new administrative relationships through which a few laggard states were forced to create[10] or strengthen their highway departments and to reform the whole loose system of highway construction which had pre-

[7] C. H. Davis, *National Highways vs. Federal Aid* (National Highways Association, Washington, 1913), p. 13. Similarly this group argued that there should be state highways which would be a state responsibility.

[8] In the Report of the Joint Committee on Federal Aid in the Construction of Good Roads (U.S., 63rd Congress, 3rd session, p. 24), the proposal was advanced for creation of "a federal highway commission in which Congress shall be the dominant influence." The committee believed that to create a bureau under the control of the administrative branch of the government would be to "make the head of the Bureau the practical dictator of road matters throughout the United States," and to stifle state initiative.

[9] In 1913 an act was passed, with an experimental appropriation of $500,000, which permitted, as one alternative, federal construction of highways. But the small amount of money and other difficulties made the measure ineffective. See Bitterman, *State and Federal Grants-in-Aid*, pp. 255–57.

[10] Ten states had "no functioning highway departments" in 1916. A. F. Macdonald, *Federal Aid* (New York, 1928), p. 99.

vailed for years. The federal Bureau of Public Roads, which was set up to administer the grants, was able by persuasion, threat, and as a last resort by withholding grants to hasten a process of reorganization which otherwise would have come very slowly; and the federal government, by providing ever more generous grants, tempted the states into construction on a vast scale.

Expenditure of the original grants of 1916 was hindered by the war, but in 1919 an additional $200,000,000 was added in the hope that an expanded program of highway construction would help the absorption of demobilized men into employment. Then in 1921 a new highway act strengthened federal controls. Although federal aid had been given for almost every type of road, debate had continued over the possibility of building a national system of roads, and the new act required that a state designate not over 7 per cent of its mileage as the roads to receive federal aid. This system of roads, which in turn was to be split into interstate (30 per cent) and inter-county (70 per cent), was to be submitted for approval to, and could be modified by, the Bureau of Public Roads. Provisions requiring state maintenance of federal-aid roads were tightened, and so also were those requiring a satisfactory state highway department. The act also pushed the states into direct administration of the construction of federal-aid roads. Small changes in the method of apportionment of the grants favored the states which had a small population, i.e., no state was to receive less than ½ of 1 per cent of the appropriation for any year; [11] and in states where the unappropriated public lands were over 5 per cent of the area, the share of any project which might be assumed by the federal government could exceed 50 per cent.[12]

Consolidation of the Grant System

The next decade brought remarkable developments. The sentiment in Congress favoring farm-to-market roads shrank as automobile registrations rose and as interstate traffic on highways grew. It became possible for the Bureau of Public Roads to define a national highway system on which federal aid was to be

[11] This increased the share of Vermont, New Hampshire, Rhode Island, and Delaware.

[12] This affected ten states, raising the federal maximum to 87 per cent in Nevada. Macdonald, *Federal Aid,* p. 101.

expended without encountering significant opposition in the states. State highway mileage was expanded; and state funds, instead of being used as grants in aid of local construction, were used more and more for direct construction and maintenance by state highway departments. This trend was favored by the Bureau, and it was stimulated also because the state governments found that the automobile traffic had placed in their hands the resources from which highways could be financed. The gasoline tax was unsuitable for collection by local, and it was suitable for collection by state governments. The revenues from it solved the question of finance, and the growth a strong sentiment favoring use of automobile revenues only for highway purposes held back diversion in the 1920's. At the same time the bait of federal aid tempted the states toward construction. The amount of state bond issues outstanding for highway purposes was $345,574,000 in 1922 and $1,425,600,000 in 1931.[13]

The part played by the federal government in the highway program should not be overstressed. In the richer and more thickly settled states federal grants helped as an original stimulus, but thereafter the program of construction and improvement went forward from its own momentum. A limitation upon the amount of federal aid per mile of road—$10,000 in 1916, $20,000 in 1919, $15,000 in 1922, and $25,000 in 1930—was set until 1932, and therefore in the states which required or preferred expensive construction the federal grant was much less than half the expenditure. In these states the influence of the Bureau was reduced both for this reason and because their highway departments followed good practices without the necessity of federal suggestion. In the poor states, with large areas and sparse population, guidance and pressure from the Bureau were much more vital, and here the Bureau made an excellent record.[14] The highway grants were, indeed, the first sort of federal aid to be thoroughly supervised and administered. Advance examination of projects, detailed progress reports, audit of expenditures, careful examination of the finished work to ensure that plans had been followed and that there was proper maintenance—all the techniques of good administration were utilized.

[13] Bitterman, *State and Federal Grants-in-Aid*, p. 97.

[14] See V. O. Key, *The Administration of Federal Grants to States* (Chicago, 1937), pp. 34–92, 93–95, for an excellent description of the techniques used by the Bureau in carrying out its policies.

An occasional brush with the states naturally was unavoidable. Highway construction had for decades been the object of pork-barrel expenditure and it was not easy to break the tradition.[15] Moreover, some states were slow to see the value of the type of highways and highway organization and planning which the Bureau regarded as desirable. Here, as always, what was a suitable policy for one state was unsuitable for another, since the states were diverse in settlement and wealth. The Bureau, while willing to permit variation, stood firmly against certain practices. Arkansas was the first state to cause serious trouble. When federal aid started, its highways were handled by a host of road improvement districts, and the federal grants were passed along to them with only a modicum of state supervision. The districts were in constant financial difficulty, and finally in 1923 the evidence of mismanagement—not to say graft—was so clear that federal aid was suspended until the state government introduced reforms.[16] In Kansas also an excess of localism hindered state supervision and participation until, in 1925, withholding of federal grants forced improvement. In other instances, especially in the south and southwest, state governments lagged in setting up proper supervision of expenditure and in assuming direct financial responsibilities.[17] Often the difficulty was inertia, but in some cases the state government feared that a highway program would be too expensive. Here Montana, in the 1920's, provided the most notable instance. In this period the state, unlike the rest of the nation, was depressed; highway construction seemed a luxury, and in 1925 federal funds were not matched. But the economy campaign soon lost its force and in the next year grants were resumed.[18]

The most serious charge which can be launched against federal

[15] Politics were, of course, never completely eliminated. See Key, *Administration of Federal Grants*, pp. 294–97.

[16] For an account of highway finance in Arkansas see B. U. Ratchford, *American State Debts* (Durham, N.C., 1941), chap. xv.

[17] It is not implied that state administration was a certain cure for the possible evils in highway finance. In 1929 grants to Maine were stopped because of dishonesty of the highway commission. "Coöperation again started after new commissioners had been appointed and the state had repaid the full amount of the aid granted on the projects involved" (Bitterman, *State and Federal Grants-in-Aid*, p. 265). In other cases the Bureau has taken less serious measures than withholding to check irregularities.

[18] Macdonald, *Federal Aid*, pp. 108–10.

grants for highways during the 1920's is that they overstimulated construction. Considering the enormous growth in highway traffic, it is hard to substantiate this charge. What is often meant is that some state and local governments issued more highway bonds than was wise and that more construction should have been financed on a pay-as-you-go basis.

Expansion and Innovation during the Depression

The depression was to have a major effect upon the amount of highway expenditure and its distribution among the levels of government. The federal aid system grew from 166,000 miles in 1930 to 235,239 miles in 1941,[19] and the mileage of state systems grew from 324,000 miles in 1930 to 477,000 miles in 1939. Many localities were wholly unable to finance roads; in some states they were given additional financial assistance, and in a few—North Carolina in 1931, Virginia and West Virginia in 1932, Delaware in 1935—there was complete state assumption of responsibility. The general swing toward centralization was marked.

As Table 23 shows, state highway expenditures (including federal grants) rose sharply with the onset of the depression, declined during 1932–33, and then rose to a new high level. The dominant influence in all of this was federal grants. These grants rose

TABLE 23

State and Federal (Excluding WPA) Highway Expenditures, 1928–1938[a]

Year	(A) State, including federal	(B) Federal	B/A	Year	(A) State, including federal	(B) Federal	B/A
	millions of dollars		%		*millions of dollars*		%
1928	830	81	9.7	1934	992	318	32.0
1929	911	78	8.5	1935	848	215	25.4
1930	1,140	94	8.1	1936	1,131	329	29.1
1931	1,091	218	20.0	1937	1,167	266	22.8
1932	955	137	14.3	1938	1,135	199	17.5
1933	782	175	22.4				

[a] U.S., 76th Congress, 3rd session, House Hearings, Federal Highway Act of 1940, pp. 30–31.

[19] Additions were made frequently. Moreover the states were permitted, after 90 per cent of the mileage originally designated as federal-aid roads had been improved, to make 1 per cent accretions. Twenty-five states have taken advantage of this provision.

from being 8.1 per cent of the total in 1930 to 32.0 per cent in 1934; and the decline since is misleading, since WPA expenditures on highways are excluded and these, 1936 to 1938, were $400 to $500 millions a year.[20]

This swing toward larger federal expenditure on highways began before the New Deal. As has already been described, in 1930 Congress "advanced" $80,000,000 and in 1932 $120,000,000 to the states for highway construction. Public approval of this sort of expenditure was general, the Bureau of Public Roads had built up satisfactory administrative controls, and the fact of state–local coöperation added to its attractiveness. With the New Deal not only were larger appropriations made, but in addition many of the conditions hitherto attached were lifted or relaxed. The $400,000,000 appropriated under NIRA, the $200,000,000 voted in 1935, and the $400,000,000 ($200,000,000 for grade crossings) in 1936 as relief appropriations did not have to be matched by the states; use of this money was permitted for secondary roads and for purposes not previously accepted, such as road widening, removal of grade crossings, and construction of links or streets connecting routes within the federal system. This enlargement was, of course, designed to widen the area in which employment could be given. The cities suffered most severely from unemployment and permission to use federal funds for construction of connecting streets was meant to help them. This extension made it desirable also to lift the limitation on the amount of federal money which could be spent per mile of road. Relief provisions were added—

[20] The following table compares total federal expenditure on highways with state and local expenditure:

Amounts Expended, in Millions of Dollars

Year	Federal	State and local	Total	Federal expenditure as percentage of total
1930	92	2,410	2,502	3.7%
1935	511	1,198	1,710	29.9
1936	729	1,584	2,314	31.5
1937	785	1,485	2,271	34.6
1938	938	1,589	2,526	37.1
1939	822	1,539	2,360	34.8
1940	656	1,628	2,284	28.7

Source: U.S., 78th Congress, 2nd session, Special Senate Committee on Post-War Economic Policy and Planning, *The Role of the Federal Government in Highway Development*, p. 12.

limitation of work to 30 hours per week, preference to local residents, employment of labor rather than machinery, etc. Then in 1936 Congress turned back once more to regular appropriations for highways, and although the relief provisions were gradually dropped, other emergency extensions were carried over.

The most general result of the vast increase in federal expenditure was a tightening of the controls exercised by the Bureau of Public Roads "within the framework of established regulations and procedures."[21] In some states money for highways was so scarce, aside from what came from Washington, that all projects fell under the scrutiny of the Bureau. Not all of these controls will disappear with the return of more normal conditions.

And in addition to changes in administrative procedure, other innovations of the emergency were embodied in the new highway act in 1936. Federal money could be spent within municipalities and without limitation on the amount of expenditure per mile of road. Provision of federal money for the elimination of grade crossings was also liberalized. Before the depression the fact that highway grants could not be spent within municipalities had restricted this type of expenditure, and up to 1933 more grade crossings were added each year than were eliminated. Thereafter the lifting of the limitation, and the emergency allocation of federal funds for elimination of crossings, inaugurated a very active program.[22] In 1936 a regular federal annual authorization of $25,000,000 was provided to be allocated among the states according to a formula which gave a weight of one-half to population, one-quarter to highway mileage and one-quarter to railway mileage.[23] The federal money did not have to be

[21] Key, *Administration of Federal Grants,* p. 354. Mr. T. H. Macdonald, the chief of the Bureau, does not, however, admit any encroachment upon state jurisdiction. "There have been," he said, "a few instances when, under the operation of the principles of the law, requirements have been made of the States which have made it necessary for them to change some of their methods of administration, but we have not only given a very generous interpretation of the principles underlying the law, but we have very patiently, in many cases too patiently, waited for the State to conform to the law before anything like drastic action was taken." (U.S., 76th Congress, 3rd session, House Hearings on the Federal Highway Act of 1940, pp. 185–86.)

[22] From 1933 to 1939 inclusive, 2915 crossings were eliminated by construction of separate structures, 1155 by reallocation of the highway or railway, and 569 were reconstructed.

[23] This formula appeared first in the Emergency Relief Appropriation act of 1935 and was carried over in 1936 into the highway act.

matched, but the federal government did not assume the costs of acquiring right-of-way or of damages to adjacent property.

These extensions which took federal highway money into the municipalities were accompanied by another extension in just the opposite direction when federal grants were made available for secondary roads. As has been noticed, the federal government in 1921 abandoned aid to these roads because what seemed desirable was a national system of roads, and this could be achieved only by restricting aid to a carefully defined mileage. Beginning in 1933, however, federal money was allotted to secondary or feeder roads and in 1936 this was continued as part of the regular aid program [24] with a grant of $25,000,000 a year, although this appropriation, unlike that of the emergency, had to be matched. The states were to select as eligible for inclusion not more than 10 per cent of their mileage outside the existing federal aid roads, submitting their selections to the Bureau of Public Roads for criticism and approval.[25] A large field for expansion of federal aid has thus been opened.

Federal Policy toward Diversion

Still another development of the emergency was diversion of motor user taxation to purposes other than highways. The Bureau of Public Roads had always frowned upon diversion, and until the depression the amount diverted was small. Depression, however, aggravated the problem. The states found motor user taxes one of the few elastic sources of revenue and they used them to provide money for such purposes as relief and education. This tug of other functions upon these revenues was viewed with alarm by highway administrators everywhere. When, in 1933, the federal government began to make relief appropriations for highways which did not have to be matched, some states discovered therein a further opportunity to curtail their own highway expenditures and to divert motor user revenues to purposes which seemed more urgent.[26] As a result diversion, which in 1931 was

[24] The authorization in the 1936 act was for the year 1938.

[25] See U.S., 76th Congress, 3rd session, House Hearings on the Federal Highway Act of 1940, pp. 214–23, where the method of selection is outlined by Mr. T. H. Macdonald.

[26] One example, mentioned by Senator Hayden, will suffice. "The theory," he said, "on which Congress made the gift by appropriations, unmatched, during the depression, was that road work was a good way to find employment for idle labor.

only $23,600,000 rose to $122,150,000 in 1934. Congress then declared by the Hayden-Cartwright act that any state reducing the amount of its motor vehicle fees and gasoline taxes which was applied to highway purposes below that provided by law on June 18, 1934 was to "be penalized not more than one-third of the Federal aid apportionments to which it would be entitled."[27] Doubtless this did serve to curb diversion, but the total diverted continued to grow[28] and a battle was waged on a wide front between those who favored diversion—usually the advocates of larger appropriations for relief and social welfare—and those who were opposed—the highway administrators and automobile organizations.

Whereas the Hayden-Cartwright act penalized diversion, the highway act of 1936 had a provision which gave a bonus for non-diversion. If a state used all its revenues from highway user taxation for highway purposes and no balance remained from which its federal grant could be matched, then the federal grant was to be available without matching. The basic notion was that states making a genuine effort to provide highways should not be deprived of grants which their more fortunate neighbors could provide with no greater effort. But the test was extremely loose, since no consideration was given to the severity of taxation which a state levied, to efficiency of collection, or to the wisdom with which the revenues, whatever their amount, were being spent. Unless standards of this sort can be applied, federal generosity here has no warrant.[29] The states that have benefited—Arkan-

Georgia diverts two and one-half million dollars to take care of convicts and then asks Congress to appropriate two and one-half million dollars to pay free men to work on the road. Is that a good argument for unmatched Federal aid?" (U.S., 75th Congress, 1st session, Senate, Hearings before the Committee on Post Offices and Public Roads, pp. 19–20.)

[27] *Report of the Bureau of Public Roads*, 1937, p. 10.

[28] Diversion of highway user revenue:

1930—$ 20,160,000	1938—$158,284,000
34— 122,150,000	39— 181,654,000
35— 147,143,000	40— 196,579,000
36— 169,344,000	41— 215,039,000
37— 161,413,000	42— 204,165,000

Source: T. H. Macdonald, "Trends in Highway Practices," a paper presented at the 19th annual meeting, Highway Research Board, Washington, D. C., December, 1939, p. 47. Figures 1939–1942 were secured from the Public Roads Administration.

[29] In 1938 the conditions were elaborated so that a state, in order to be relieved from matching, had not only to be devoting all of its motor-user taxes to highway purposes, but also using 90 per cent for administration and maintenance of the state system and for debt service.

sas, West Virginia, North Dakota—are poor states, but this is no defense of the erroneous basis upon which aid is being extended to them.

The whole position of Congress and of the Bureau of Public Roads—now the Public Roads Administration—toward diversion should be reconsidered. As the matter now stands, a state which had diverted before the arbitrary date (June 1934) set by the Hayden-Cartwright act has an advantage over one which had not. Mr. T. H. Macdonald, indeed, believes that the Hayden-Cartwright act recognizes too much diversion and that diversion as such should be penalized.[30] Yet surely the assumption behind this position is incorrect. It is that a strict benefit theory should govern disposition of highway user revenues. On grounds of theory, earmarking this sort of revenue for the benefit of highway users is questionable.[31] And, even if one holds to a benefit theory, the present application of it leads to absurd results because no consideration is given to the extent which a state may or may not need funds for highways. A large and thinly settled state may require all of its highway user revenues, and more, for its highways; a small and thickly settled state may secure more from its highway user revenues than can wisely—in the light of other needs—be spent on highways. States like New Jersey, Rhode Island, New York may have adequate highway systems, and a penalty for spending some of their highway user revenue for education or for relief may be utterly misdirected.

The penalty of the Hayden-Cartwright act has been applied. During 1936–37

> a careful review showed that motor-vehicle revenues had been diverted from highway purposes by legislative acts subsequent to 1934 in Georgia, Maryland, New Jersey, and Pennsylvania. Each of the States was notified of this finding and given an opportunity to show why a deduction in Federal-aid funds should not be made.[32]

[30] See, for example, his statement before the House Committee on Roads, U.S., 75th Congress, 3rd session, House, Hearings on the Federal Aid Highway Act (1938), p. 377.

[31] The grounds on which earmarking can be justified are two. In the first place, highway users secure particular benefits from highway facilities for which particular payments can reasonably be exacted. Obviously, however, general benefits accrue to the public generally. Moreover, the gasoline tax can be defended simply as an excise from which revenue may be secured. In the second place, earmarking has the practical advantage that it provides highway departments with an assured revenue, thereby giving them considerable freedom from legislative interference. Reasonable continuity in fiscal and administrative policy is secured.

[32] *Report of the Bureau of Public Roads,* 1937, p. 11.

All of the states except New Jersey restored the diversions; New Jersey did not and therefore $250,000 was deducted from its grant in August 1937. On June 2, 1938, $472,900 was withheld from Massachusetts, and in late 1940 $504,000 was withheld from Georgia.

It is somewhat ironical that the federal government, which imposes penalties upon the states, has for years diverted the revenue secured by it from taxation of gasoline, etc. The American Association of State Highway Officials, despairing of repeal of the federal tax on gasoline, has taken the position that the revenue from it should be earmarked as a source of federal grants for highways.

Recent Issues

Even before the war there was a feeling in many quarters that federal expenditure for highways, blown up by the depression, should be reduced. In 1937 President Roosevelt sent a message to Congress to this effect. At once the House Committee on Public Roads protested,[83] and although the president in a further letter pointed out that, in the interest of budget balancing, cuts should be made somewhere, Congress did not feel that roads were the proper item.

Development of a system of interregional highways and of express roads through the larger cities also was given consideration at Washington.[84] The most interesting suggestion arising out of the discussion was that the federal government intervene to enable states and municipalities to solve more expeditiously and cheaply the acquisition of right-of-way. During the depression difficulties in securing right-of-way very frequently delayed the inauguration of highway projects. What is required here is long-range planning on a coördinated basis. Neither states nor localities have proceeded on this basis.[85] Instead acquisition is postponed until the last moment and this leads to high costs, the taking of inadequate parcels of land in the light of probable future

[83] U.S., 75th Congress, 3rd session, House, Hearings on the Federal Aid Highway Act (1938), p. 9.

[84] U.S., 76th Congress, 1st session, House Document No. 272: *Report of the Bureau of Public Roads, Toll Roads and Free Roads.*

[85] Federal aid has never been given to acquire right-of-way, and in many states acquisition is left in local hands.

needs, and excessive litigation. The Bureau of Public Roads declared that

> the right-of-way problem could be greatly simplified and in a large measure eliminated with respect to major highways and streets if there were some central agency with sufficient funds and authority of law to acquire the lands necessary for the improvement of such highways and streets at a period substantially in advance of the time when the improvements actually would be made. If this were done, then the right-of-way previously acquired could be made available to the highway authorities charged with the duty of making the improvements, either on a rental basis or at the price paid by the acquiring agency, plus the costs of such acquisition and any interest charges paid thereon to the date of the use of the lands.[36]

This body should be federal "in order that its jurisdiction and authority might be general throughout all of the States, and that its operations could be on such a basis that it would be in whole or in substantial part self-liquidating." The proposal has merit and it will certainly require consideration after the emergency.[37]

Conclusion

This brief survey at least indicates that the federal government, from a modest beginning, has become deeply immersed in the problem of provision of highways. In the main its activities have had commendable results, but because of the piecemeal approach and because of political exigencies, the whole program needs review and integration. When in 1916 federal aid was begun, highway construction and maintenance was entrenched as a local function with some state assistance and supervision. At present centralization within the states has made great strides and an important mileage has been taken out of local hands. Should there not be a similar emergence of a federal system in which highways of national importance either strategically or as regional communications would become entirely a federal responsibility? No detailed argument in support of this step will be presented here, but the principle behind it is that in cases where governmental responsibility can be allocated with reasonable

[36] *Ibid.*, p. 120.

[37] The defense highway act of 1941 provided for use of federal money to cover the cost of right-of-way, and for acquisition by purchase or condemnation. In bills now (1944) before Congress the federal government is allowed to acquire land and pay the cost out of the state's share of federal aid (U.S., 78th Congress, 1st session, H.R. 2426).

clearness to one level of government, the allocation should be made. Responsibility for highways *in general* cannot be neatly carved up among the different levels of government; some overlapping must remain. But more can be done than has been done, particularly in the direction of setting aside a federal sphere. Not only would this appear to be in accord with economic and political trends; it would in addition serve in some measure to relieve the unbalance which has existed between governmental responsibilities and revenues.

Such a step would not, of course, mean the elimination of federal aid. Even if a federal mileage was set aside, federal assistance would still be needed for a considerable portion of the remaining mileage, most of which should gradually be brought under exclusive state jurisdiction. The recent extension of federal aid to secondary roads is of dubious wisdom both in terms of federalism and of political morality. And the basis on which aid is given requires examination. For example, is the long-standing formula by which aid is allotted according to state area, population, and post-road mileage now appropriate? During the depression the special unmatched grants were allotted in order to give a larger weight to population for the reason that this appeared to permit an allocation corresponding more closely to needs rising out of unemployment.[38] Beyond question a still larger allocation in terms of population would have been justifiable during the depression. But Congress was timid about departing far from an established formula and in 1936 the modification was dropped. Yet Congress has not hesitated to make a permanent modification of the old formula in favor of the public land states. Since 1921 these states have not had to match the highway grants. The federal share, instead of being 50 per cent, increases by a percentage equal to one-half of the ratio which the unappropriated public lands bears to the total area of such a state. This provision raises the federal contribution to 83 per cent in Nevada and to a less generous percentage in the other public land states. Behind it is the assumption that, since the public lands are tax-exempt, the states in which these lands lie should not be forced

[38] By the depression formula, seven-eighths of an appropriation was allocated according to the regular formula, the remaining one-eighth being divided according to population. This meant that, in the total allocation, population had a weight of five-twelfths.

to place heavier taxes on lands privately held. The highly tenuous connection between the extra federal share and the area of public lands is, however, very apparent. Probably the supposed disability associated with a large area of public lands has been grossly over-compensated by federal legislation.[39] Patching of this sort on a formula which cannot in any case be defended in detail is undesirable. An overhauling of the whole program of federal aid to highways might well result in distribution to the states according to estimates of the

cost of a reasonable program of standard grade which would make allowance for varying traffic needs. This program could consider such factors as the relative importance of interstate traffic, the extent of completion of the highway system, and so outline the number and type of federally aided highways necessary.[40]

The war greatly modified the highway program. The system of federal-aid highways naturally included most of the strategic

[39] The special legislation favorable to the public-land states cannot be listed here, but a few features concerning highways should be mentioned. Since 1916, appropriations to be divided among the national-forest states have been made for the construction of forest highways, the division being one-half according to the area of the national-forest land and one-half according to the value of this land. Construction of these highways is a federal job with only incidental contributions by the states and localities. For the fiscal year 1940, $6,667,000 was apportioned among forty-two states for forest highways. Besides the forest highways, there are forest development roads, administered by the federal Forest Service. Appropriations for them are allocated according to no definite formula on estimates of need for construction and maintenance. For the fiscal year 1940 the appropriation was $3,333,000. The following table indicates the states in receipt of the largest amounts under 1940 authorizations:

	Forest highways	Forest road development
	(millions of dollars)	
California	952	534
Oregon	898	376
Idaho	687	492
Montana	535	325

Beginning in 1930 Congress has made a special appropriation for the construction and maintenance of roads through public lands other than forest reservations where such land is more than 5 per cent of the total area of the state. There are fourteen such states, and in 1940 the states receiving the largest shares of the $2,000,000 appropriated were Nevada $436,000, Arizona $310,500, Utah $227,600.

Congress also provides for construction of approach roads to national parks and monuments, and it has provided special funds for the repair of highways and bridges on the federal aid system which may be damaged by natural catastrophes.

[40] Bitterman, *State and Federal Grants-in-Aid*, pp. 511–12.

roads of the nation and state highway departments have coöperated in giving precedence to needs arising out of war. But federal-aid projects could be initiated only by the states, they required state matching, and they were protected by legal and administrative restrictions which were an embarrassment to speedy construction. Moreover, roads in military and naval reservations, access roads to such areas, etc., were strictly a national responsibility to be paid for by federal money. Some needs of this sort were met at first through WPA, but Congress also made funds available for direct highway construction by the appropriate federal agency. In general, however, construction and maintenance work were cut by war scarcities and by restrictions on borrowing.

The Public Roads Administration, in coöperation with state highway departments, has laid plans for a vast post-war expansion. The details of these plans will not be examined here. They contemplate, however, that the federal government will contribute $1,000,000,000 a year for three years for construction to be divided so that $500,000,000 of this amount is for the federal-aid system (including a proposed interregional system), $291,000,000 for secondary feeder roads, and $209,000,000 for urban streets. The matching formula is to be 75 per cent federal and 25 per cent state–local, except in the case of urban streets when the formula is 50–50. Moreover, the formula for allocation among the states is one-half population, one-fourth area, and one-fourth post-road mileage. Obviously it is proposed to give the needs of urban communities and of industrial states a heavier weight than in the past.[41]

[41] The House Committee on Roads reported out H.R. 4915 on June 5, 1944 (U.S., 78th Congress, 2nd session, House Committee on Roads, Post-war Federal-aid Highway Act of 1944, Report No. 1597). The report recommended an annual appropriation of $500,000,000 for three years—half the amount proposed by the Public Roads Administration. The new formula for allocation was accepted, but the new matching formula became 60–40 for the first year and 50–50 for the second and third years.

CHAPTER X

PUBLIC HEALTH

No National Program of economic security can be regarded in any sense as complete or effective without adequate provision for meeting the risks to security which arise out of ill health. *Social Security in America,* p. 315.

GOVERNMENTAL INTEREST in public health services is a recent development. Legislative regulations about water pollution and nuisances can, indeed, be found early, but the historical and antiquarian interest of these efforts should not obscure their insignificance. Even into the nineteenth century "public health measures related chiefly to overcrowding, uncleanliness of streets, regulation of slaughter houses, public baths and pig-sties." [1] The progress of scientific knowledge in all fields of medicine far outstripped its application in public practice.

The primary governmental unit in dealing with public health was local, but in 1869, through the vision of Lemuel Shattuck, Massachusetts organized the first state board of health, and other states slowly followed this example. State boards or departments increased their responsibilities and authority as it came to be recognized that control of communicable disease, prosecution of preventive health services, and provision of many types of medical care required an attitude, as well as financial resources, which local governments did not have. State governments assumed the task of providing special types of institutions, such as sanatoria, hospitals for the insane, public health laboratories. They participated in coöperative activities—school health work, infant hygiene, industrial hygiene, public health nursing, maternal and child health service, venereal disease control—by giving guidance, supervision, and financial support to the local administrative units. Moreover, state governments undertook duties indirectly related to public health such as factory inspection, food and drug regulation, workmen's compensation, licensing of doctors, den-

[1] Wilson G. Smillie, *Public Health Administration in the United States* (New York, 1940), p. 13.

tists, nurses, etc. It is broadly correct to say that state and local governments gave more attention to preventive services than to medical care. Yet provision of public medical care for the poor was widespread and it was "generally accepted that medical service may be freely given to those with a much higher income than is considered as denoting eligibility for the receipt of other necessities."[2] In short, the public medical services did not rest upon a narrow basis of poverty because disease carried a threat to the public and because medical care, applied early, might prevent permanent dependency. In states which were relatively rich or in which public interest had been aroused, governmental health services in the twentieth century came to have a wide range; in other states little was done until after 1932. But when, during the depression, the number of those increased who could not afford to pay for medical care, and when a broader concept of government responsibility was accepted, a rapid expansion of public health services took place.

The federal government has no direct constitutional authority over public health. This has not, however, prevented the development of public health activities in order to carry out its enumerated powers.

> The power of regulating interstate and foreign commerce, the power to tax articles, the power of appropriating federal money for many and varied purposes under the term "general welfare," the power of limiting or forbidding the uses of the national postal monopoly, the treaty-making power, the war power, the power to govern territories and the Indian tribes—together make an imposing domain in which national health services may be developed.[3]

One of the earliest health activities of the federal government arose out of the fact that certain classes of people have no local domicile. The men of the army and navy are one example, merchant seamen are another. These men, when discharged or disabled, had no claim for relief or hospitalization upon a local government; and therefore Congress, in 1798, assumed responsibility by providing a rudimentary system of compulsory sickness insurance and establishment of marine hospitals. For many dec-

[2] Michael M. Davis, *Public Medical Services* (Chicago, 1937), p. 116.

[3] R. D. Leigh, *Federal Health Administration in the United States* (New York, 1927), p. 77. Chapters ii and iii give a succinct account of the constitutional issues.

ades the plan of contributory insurance was badly run and in 1884 it was replaced by direct governmental medical relief. The Marine Hospital Service gradually was given new jobs until its original task was completely overlaid, and in 1912 this was officially recognized by a change of name to the United States Public Health Service.

Another job which had to be performed by the federal government was medical care of men actually in the army and navy. During the Civil War this became a tremendous task, and after the peace the young men in the Army Medical Corps turned to scientific research with remarkable results. This phase of the work of the Corps has continued to the present. Still another duty of the federal government has been provision of hospitalization and medical services for veterans of World War I. It has also from necessity provided public health services for Indians.

Perhaps the clearest instance of the transference of a governmental function from local to federal hands is maritime quarantine.[4] Early governmental efforts against the great epidemic diseases were left to the seaports, and "in those days of stagecoaches and sailing vessels it was quite true that disease in Charlestown was of little importance in Boston. . . ."[5] The first federal quarantine act in 1796 merely gave the federal offices at the ports the duty of aiding in enforcement of state and local quarantine regulations. And this authority remained static for decades, despite a change in circumstances which made the arrangement an anachronism. Opposition of those who feared that federal quarantine would be the entering wedge for larger federal controls held back legislation until 1878, when the national quarantine act declared that federal regulations could be made so long as they did not conflict with those of the state and local authorities.[6] Thereafter, until 1893, progress was slow. But gradually the dual system of quarantine was reduced mostly by voluntary action. The superiority of the federal service became too glaring even for local pride to overlook.

It would be fatuous to assume that the painful history of administrative evolution, especially the rate of evolution, represents the ideal method of

[4] See Leigh, *Federal Health Administration,* chapter xi.

[5] *Ibid.,* p. 284.

[6] In the next year, 1879, a severe epidemic of yellow fever frightened Congress into passage of legislation which declared that, when state and local regulations were inadequate, additional federal regulations could be made.

federal growth. The record, especially the *Record*, is only too full of legal stupidity and blindness, of disingenuous assertion of the empty formulae of state and local rights in the face of superior and more efficient national performance.[7]

Ultimately, however, federal control became complete.

Federal controls over internal commerce in the interest of national health began later and have gone less far. Inspection of interstate supplies of water and of meat, regulation of food and drugs, hardly got under way until the twentieth century. Here there has been a development of coöperative federalism which may be a prelude to further extension of the federal power.

Early Federal Grants in Aid

The two federal agencies of most importance in coöperative health work are the Public Health Service and the Children's Bureau which, until recently, have gone along independently and not without the development of considerable professional jealousy.

The first use of federal grants in aid for public health work was by the Chamberlain-Kahn act of 1918. Public interest in control of venereal disease had been stimulated by the war and it seemed that measures of control should extend to the civilian population. The act, therefore, provided an appropriation of $1,000,000 for each of two years to be distributed as grants to the state governments on the basis of population. Administration was handled not directly by the Public Health Service but by an Interdepartmental Social Hygiene Board. Unlike most federal aid measures which have started on a limited basis, this one did not grow. After two years Congress first cut and then stopped the appropriation for it. In the more wealthy states the program was continued without federal aid; in some of the poorer states the small size of the federal program had failed to be a stimulus, and in others there was sharp curtailment.

The next venture in grant legislation for public health, the Sheppard-Towner act of 1921, was hardly more successful. The Children's Bureau had, after 1912, initiated special federal activities on behalf of maternal and child health, and in 1921 as a result of the stimulus given to all social work by the war, Congress passed the Sheppard-Towner act which provided grants of $1,-

[7] Leigh, p. 319.

240,000 a year for five years to be used "for the promotion of the welfare and hygiene of infancy." Each state was to be allotted a flat sum of $10,000 and its share of the remainder on the basis of population (the remainder and $5,000 of the flat grant had to be matched). This modest pioneer legislation encountered virulent opposition from those who purported to see in it an invasion of the powers of the states; and it appears that many medical men were suspicious, if not hostile. The Public Health Service of the federal government had been critical of the original proposal and professional jealousy existed between it and the Children's Bureau. The Service argued, with much plausibility, that what was needed was integration of public health work and development of a broad program, rather than stimulus of one type of work. The Children's Bureau replied that the situation with respect to maternal and infant health was serious enough to deserve special attention. But political opposition, rather than the merits of this professional argument, was to decide the fate of the measure, and although it survived a test before the Supreme Court,[8] Congress in 1929, after permitting an extension of two years, allowed the grants to expire.

The threat which always hung over this program hindered its acceptance in some states and each year only about one-quarter of the federal appropriations was used. There was, for the same reason, weak federal administration. Discontinuance of the grants left the states with the choice of expanding their expenditure to take up the slack or of curtailing the program, and the onset of depression made many choose the latter course. In 1934 the total expenditure was $1,157,000 and in thirty-five states the expenditure was less than in 1929.[9]

The depression at first brought little change in federal health activities. The Public Health Service, beginning in 1931, made special efforts to give assistance in areas which had suffered severely from drought, but until the establishment of the FERA, expenditure was small. The start of a new and broader program came with the Social Security act. The Committee on Economic Security declared that "no national program of economic security can be regarded as in any sense complete or effective without adequate provision for meeting the risks to security which rise out

[8] *Massachusetts* v. *Mellon* and *Frothingham* v. *Mellon*, 262 U.S. 447.

[9] *Social Security in America* (1937), pp. 272–73.

of ill health."[10] The problems were not, to be sure, peculiar to depression, but evidence was accumulating that the depression was taking a toll upon national health. Families with no employed wage-earners in 1932 were found to have a rate of disabling sickness greater by 48 per cent than families having full-time workers;[11] and in 1934, for the first time in decades, the annual death rate in large cities increased despite the absence of serious epidemics. It was rational to associate the evidence of worsened health with the decrease in state–local expenditure for public health work.[12] Even in good times the coverage and amount of public health work were inadequate. Beginning in 1917 Congress had given the Public Health Service small sums for study of, and rural demonstration work in, rural sanitation, and the Service became convinced that the primary need was development of general facilities for health work, especially by provision of full-time health officials—a health officer, a sanitary inspector, and a public health nurse—operating on a county basis. Education of state and local governments to this belief by demonstration was attempted with considerable success, since by 1930 demonstration projects in rural health work were being carried on in two hundred and four counties in twenty-four states. This was, of course, only a fraction of the field, since there were twenty-five hundred rural counties in the nation.[13] It seemed clear that, instead of leaving so large a responsibility with the state and local governments, the federal government should intervene with a substantial program of grants in aid. By the Social Security act the federal government did take a large step forward by providing grants for public health work, maternal and child health services, crippled children, and child welfare.

Public Health Services

The Social Security act put the federal–state coöperative health work on a regular and enlarged basis by providing $8,000,000 a year to be allotted in grants "to assist States, counties, health

[10] *Ibid.*, p. 315.

[11] *Ibid.*, p. 317.

[12] "The per capita expenditure from tax funds for public health in fifty-three cities in 1934 was 77.5 cents as contrasted with 93.8 cents in 1931." *Ibid.*, p. 317.

[13] In 1934 the federal government spent perhaps $5,000,000 for public health work, some of it from the funds of the FERA.

districts, and other political subdivisions of States in establishing and maintaining adequate public health services, including the training of personnel for State and local health work"; [14] and also $2,000,000 a year for extension of public health investigations by the Public Health Service. The $8,000,000—which Congress in 1939 raised to $11,000,000—was to be apportioned by the Surgeon-General of the Public Health Service among the states on the basis of (1) population, (2) special health problems, (3) financial needs, the precise decision being made after "consultation with a conference of the State and Territorial health authorities." [15]

Obviously the Surgeon-General of the Public Health Service, as the administrative officer, has been left with remarkably wide discretionary power. An effort has been made to build up semi-objective indices of financial needs and, to a less extent, of special health problems; but the administrator has really been able to make allotments as his professional judgment indicated. Let us see what has been done. In 1936, 57½ per cent of this total was distributed on the basis of population, 22½ per cent on the basis of special health problems, and 20 per cent on the basis of financial need. Since then the basis has been shifted so as to give less weight to population. For the fiscal year 1941, 29.4 per cent of the allotment was on the basis of population, 41.2 per cent on the basis of special health problems, and 29.4 per cent on the basis of financial need. Distribution according to population raises no question, but measurement of financial needs and special health problems do. The major determinant of the share distributed according to special health problems is the number of deaths in each state from all infectious and parasitic diseases and from pneumonia.[16] But in addition two other determinants have been used. Account has been taken of the relative cost of rendering health services in the different states, and also of the mere fact that certain health programs were in existence in the various states. Recently, of the total distributed according to special health programs (e.g., 40–41 per cent), three-quarters has been according to mortality, one-quarter according to relative cost

[14] *Social Security in America,* p. 338.
[15] Social Security act, section 602 (c).
[16] The venereal diseases are omitted because they receive aid in another program; influenza is omitted because the figures for it are variable and unreliable.

of services, and one-quarter as a remainder. The major determinant of the share distributed according to financial need has been per capita income (averaged for several years) of the states as computed by the National Industrial Conference Board or by the U.S. Department of Commerce.[17]

The regulations of the Surgeon-General with respect to matching are difficult to describe with brevity. In 1936, by administrative decision and not because of a requirement in the law, the allotment on the basis of population had to be matched. Of the amount allotted on the basis of special health problems, one-tenth had to be matched and the remainder, which was used to train personnel in the states, had not. Practically no matching was required of the amounts allotted on the basis of financial need. Since then numerous changes have been made and behind them has been the aim of blocking any decrease and of encouraging expansion of state and local appropriations. For 1941 one-half of the amounts allotted to the states on the basis of population and for special health problems had to be matched dollar for dollar by existing appropriations for public health work, and one-half with new appropriations made since January 1, 1935. Again, however, the Surgeon-General was allowed to alter these requirements.

One other system of grants in the field of public health has been that for the control of venereal disease. The attempt after 1935 to raise public interest in this problem met with astonishing success, and in 1938 Congress provided grants starting at $3,000,000 for 1939, rising to $6,000,000 for 1940, to $12,000,000 for 1941, and thereafter at amounts necessary to carry out the purposes of the act.[18] Here, as in connection with the public health services, a wide discretion was left in the hands of the Surgeon-General. The grants were to be apportioned on the basis of population, the extent of the venereal disease problem, and the financial needs of the states; and recently the actual allotment has been approximately 29 per cent, 42 per cent and 29 per cent. Matching is not required by law, but it has been by regulation for those portions

[17] Actually the formula for measuring financial need has been more complicated than this, but a detailed description seems unnecessary.

[18] The actual appropriation of the fiscal year 1941 was $6,200,000 and the payments were $5,514,000. *Annual Report of the Surgeon-General of the Public Health Service of the United States*, 1941.

of the grants distributed on the basis of population and the extent of the venereal disease problem, because of the natural feeling that state and local financial participation was desirable.[19]

The most interesting aspect of the grants for the control of venereal disease and for the public health services has been the absence of Congressional curiosity or alarm at the very great discretionary powers given to the federal administrator. No very satisfactory explanation can be offered. The amounts involved are, of course, not large; members of Congress do not possess an understanding or knowledge of the technical issues involved in this sort of program; the work does not touch any well-organized body of voters who are organized in a pressure group; federal administration has been remarkably efficient and it has worked through state officers who are technicians and who have an interest in keeping politics out. None of these reasons by itself seems adequate except, perhaps, the last. The Public Health Service has, for many years, worked through state health officers, and each year a conference is held at which common problems are discussed and committees make recommendations about such questions as the apportionment of federal grants. This sort of successful coöperation may explain the acquiescence of Congress to delegation of wide discretionary powers to administrative officers.

Certainly the recent accomplishments in the field of public health have been great. Under the stimulus of federal grants the number of counties with local health departments under the full-time direction of a medical health officer has risen from 594 in 1935 to 1,391 in 1939.

> Thirty-seven state departments now [1939] have divisions or bureaus concerned with the promotion or supervision of local health services; twenty-seven have bureaus or divisions of industrial hygiene; thirty-five have dental units or bureaus; seventeen states carry on pneumonia control programs; five states have cancer control programs; and practically all states have improved their public health nursing, engineering and vital statistics functions.[20]

Since then progress in all of these directions has been rapid.

[19] U.S., 75th Congress, 3rd session, Senate Hearings on S. 3290, Investigation and Control of Venereal Diseases, pp. 90–91. The division of venereal diseases reported that in 1941 the ratio of the expenditure of federal to state–local funds was 48 to 52.

[20] *Annual Report of the Surgeon-General of the Public Health Service,* Fiscal Year, 1939, p. 22.

The example of wise exercise of administrative discretion does not, however, provide any formula which can be applied to other grant programs, and certainly the basis used for distributing the public health grants will not bear critical analysis. A number of components—population, per capita income, mortality—are thrown together in a manner which makes sense only because it has worked. Pragmatically, rather than logically, the method has been a success.

The other important health services for which grants are provided are handled by the Children's Bureau. In 1935 the Committee on Economic Security recommended "that the Federal Government through the agency of the Children's Bureau should again assume leadership in a Nation-wide child and maternal health program." [21] This program was to be primarily consultive, educational, and promotional. State divisions dealing with maternal and child health were to be assisted; maternity nursing and child health demonstration, especially in rural areas, were to be developed. These recommendations were accepted and the Social Security act authorized an annual appropriation of $3,800,000, subject to conditions which, in a broad way, were usual in other grant-in-aid programs.[22] Distribution of the grants, however, was to follow a new pattern. Each state (Hawaii, Alaska, District of Columbia were so counted) was to be allotted yearly a flat grant of $20,000 plus its share of a further allotment of $1,800,000, this to be determined by the ratio of live births in a state to total live births in the United States. The flat grants, together with the $1,800,000, were designated the "A" fund by the Children's Bureau, and it had to be matched by the states. But an additional yearly allotment of $980,000—the "B" fund—was to be distributed by the Secretary of Labor on the basis of the financial need of the state in carrying out its program, although consideration was to be given to the number of live births. This portion of the grant did not have to be matched. Thus Congress, six years after it had killed the Sheppard-Towner act,

[21] *Report of the Committee on Economic Security*, p. 38.

[22] The original bill, as introduced into Congress, had given the federal government considerable discretionary power over state standards, but these were taken out or altered by Congress for the same reasons as similar action was taken concerning old-age assistance.

passed legislation which renewed and enlarged the same grants and greatly increased the discretionary powers of the federal officers.

In 1939 Congress raised the annual grant for maternal and child health services to $5,820,000, the "A" fund becoming $1,040,000 plus $2,800,000, and the "B" fund $1,980,000. The method of allotment of the "A" fund remained the same. That for allotting the "B" fund is worth notice. Each state is given a uniform allotment of $5,000, plus its share of the remainder ($1,720,000) on the basis of need.[23] The statistical indices used to measure need have been sparsity of population, maternal mortality, and infant mortality. Precise information concerning how these indices are made up is not made public, but approximately equal weight has been given to each group. Variation is possible, however, and the objective determination of the three indices themselves has seldom been possible because adequate figures do not exist. The plain fact is that the Bureau can get the results which it wants from the indices, and that the indices are not controlling. Even if sparsity of population, maternal mortality, and infant mortality could be accurately measured, it is by no means clear that they furnish the best basis on which to allocate these grants.

Before the Social Security act was passed, the states and localities were estimated to be spending approximately $5,500,000 a year for the care of crippled children, the greater part going for hospitalization.[24] The act was to enable improvement and extension of the program by federal grants, subject to conditions which paralleled those in the other programs. The yearly federal appropriation was to be $2,500,000—raised in 1939 to $3,870,000—of which each state was to be allotted a flat sum of $20,000, and its share of the remainder distributed by the Secretary of Labor "according to the need of each State—after taking into consideration the number of crippled children" and the cost of furnishing services to them.

Here again the device of an "A" fund, which had to be matched, and a "B" fund, which did not, was used. The "A" fund appropriation in 1941 was $2,870,000, with $20,000 going to each state, plus its share of the remainder ($1,830,000) on the basis of financial need and the estimated number of crippled chil-

[23] In 1941, $220,000 was reserved for special medical-care projects.
[24] *Social Security in America,* p. 284.

dren.[25] The "B" fund appropriation in 1941 was $1,000,000, and the basis of allotment took account of sparsity of population, number of crippled children, mortality rate of children, cases of poliomyelitis. Precise information as to the formulas used is not available.

Urban communities in the United States developed social services for neglected, homeless, and dependent children earlier and more adequately than did rural areas. When, therefore, by the Social Security act, an annual federal appropriation of $1,500,000—raised in 1939 to $1,510,000—was provided for grants to the states, it was natural that special attention should be paid to the needs of the rural areas. In 1941 a flat allotment of $10,000 was made available to each state, plus its share of the remainder divided according to the ratio which the rural population of a state bore to the total rural population. Matching was not required, and aside from the requirement that plans have to be "developed jointly by the State agency and the Children's Bureau," the grants were made without conditions.

Recent Developments

Although federal participation in public health work was greatly increased by passage of the Social Security act, a comprehensive program was not achieved and plans had still to be made for progress toward this larger goal. In 1935 President Roosevelt appointed the Interdepartmental Committee to Coördinate Health and Welfare Activities and it, in turn, appointed a Technical Committee on Medical Care. This Technical Committee prepared a program and early in 1938 a National Health Conference was called at Washington to examine and publicize the program. Then in 1939 Senator Wagner introduced a "national health bill" to implement these plans.[26] In this bill the principal fiscal instrument was to be the grant in aid. "The wide range of social organization and economic resources among the several states" made it desirable that a public health program should

[25] In making reapportionments a variety of other factors were used. See *Annual Report of the Secretary of Labor*, 1941, p. 117.

[26] U.S., 76th Congress, 1st session, S. 1620. In 1935–36 a national health survey was conducted as a WPA project under the guidance of the Public Health Service, and this survey provided much of the statistical material which was used to show the need of legislation.

rest "upon a partnership in which the States take the initiative and assume the basic responsibility, and the Federal Government coöperates through grants-in-aid for State programs which meet certain basic conditions requisite for federal approval." [27]

The principal premise of the new program was that "the chance for health and even for survival is far less among low-income groups than among those who are in moderate or comfortable circumstances." [28] Wage-earners in families with incomes of less than $1,200 a year suffered twice as many days of disability as those in families with incomes of $3,000 and more. Yet this association between low-income and sickness could, in the opinion of the sponsors of the program,

> be broken by well-tested methods to prevent and to check illness and so to prevent the poverty it brings. There is incontrovertible evidence that the level of health has been raised for whole communities by the application of simple, accepted methods to provide public-health services and insure facilities for medical care.[29]

That this declaration of faith appears naïve need not concern us here.

The plan consisted of five main parts, two of which involved extension of programs already in existence under the Social Security act as well as three new programs (Titles XII, XIII, XIV). Table 24 shows the federal appropriations proposed in S. 1620:

Certain significant features of the new proposals will be singled out for discussion. All of the grants, except those for hospitals, were to be on a variable matching basis varying from 33⅓ per cent to 66⅔ per cent. The states were to be arranged according to their relative financial resources and the federal government would contribute grants, varying from 33⅓ per cent in the case of rich states to 66⅔ per cent in the case of the poor states, of the total amounts to be expended under the state plans. While details for each program cannot be given, the aim was to follow the methods developed by the Public Health Service in allotting its grants. Admittedly the determination of formulas for the measurement of state financial resources and for the determination of variable matching proportions raised problems which had

[27] U.S., 76th Congress, 1st session, Hearings on S. 1620, p. 25.
[28] *Ibid.*, p. 22.
[29] *Ibid.*, p. 23.

TABLE 24

FEDERAL APPROPRIATIONS PROPOSED IN S. 1620

Purpose[c]	Present Authorization under the Social Security Act	Proposed Authorization under S. 1620[a]			
		Fiscal year 1940	Fiscal year 1941	Fiscal year 1942	Succeeding years
		(In thousands of dollars)			
Title V:					
Part 1: Maternal and child-health services	$3,800	$8,000	$20,000	$35,000	b
Part 2: Medical services for children, including crippled children	2,850	13,000	25,000	35,000	b
Part 5: Administration, investigations, and demonstrations, etc.	425	2,500	b	b	b
Title VI—Public health work and investigations:					
Part 1:					
Payments to states	8,000	15,000	25,000	60,000	b
Administration, studies, demonstrations, etc.	....	1,500	b	b	b
Part 2: Investigations	2,000	3,000	3,500	4,000	b
Title XII:					
Grants for general hospitals	....	8,000	50,000	100,000	b
Grants for mental and tuberculosis hospitals	....	b	b	b	b
Administration, etc.:					
Public Health Service	....	1,000	b	b	b
Public Works Administration (etc.)	....	b	b	b	b
Title XIII:					
Grants for medical care	....	35,000	b	b	b
Administration	....	1,000	b	b	b
Title XIV:					
Grants for temporary disability compensation	....	10,000	b	b	b
Administration	....	250	b	b	b
Total	17,075	98,250			

[a] These amounts replace, and are not additional to, the amounts authorized by the Social Security act.
[b] A sum sufficient to carry out the purposes of [this part of] this title.
[c] U.S., 76th Congress, 1st session, Senate Report No. 1139: *Establishing a National Health Program*, p. 31. See also *The Nation's Health*, Discussion at the National Health Conference (Washington, 1939), p. 46, for the scale of expenditures expected in the tenth year of the program.

not been worked out, but the hope was that much could be left to the discretion of the administrative officers.

Both at the National Health Conference and during the Hearings on S. 1620 the new scheme was under heavy fire. Officers of the American Medical Association were sharply critical. Dr.

Fishbein denied that medical care was "the most immediate and pressing problem for the American people" and he asserted that the program was a request to the medical profession to sign a prescription for "Redway's Ready Relief." [30] The federal government was asked to coördinate its own activities in the field of public health before it embarked on new ventures. Because of these criticisms and because of the current new demands upon the finances of the nation, the public health bill is unlikely to make rapid progress.[31]

With the war new demands were made upon the public health services. Congress in March 1941 appropriated half a million dollars to provide personnel and facilities in critical areas, as well as smaller sums for special purposes. Extra funds were provided also through the Federal Works Administration to construct waterworks, sewers, hospitals, etc. In subsequent years larger supplemental and emergency appropriations were made for every phase of the public health work described above, including emergency maternity and infant care.

[30] *Proceedings of the National Health Conference* (Washington, 1938), pp. 116–17.

[31] The evidence is, moreover, that the supporters of a public-health plan have made a major shift in plans. A new bill has been prepared—the Wagner-Murray-Dingell bill (78th Congress, 2nd session, S. 1161 and H.R. 2861)—which is to be a general revision of the Social Security act. In the annual report for 1943 the Social Security Board declared its support of a system of insurance against permanent disability to be made a part of old-age and survivors' insurance. The Board also wants cash benefits for temporary sickness, the early period of disabilities, and the costs of medical care. Such a comprehensive system of social insurance might, the Board estimates, be obtained at a rate of 12 per cent of covered earnings for employers and employees combined. Thus the new scheme contemplates federal administration rather than grants in aid.

CHAPTER XI

UNEMPLOYMENT COMPENSATION AND EMPLOYMENT OFFICES

It is too late today for the argument to be heard with tolerance that in a crisis so extreme [as that after 1929] the use of the moneys of the nation to relieve the unemployed and their dependents is a use for any purpose narrower than the promotion of the general welfare. JUSTICE CARDOZO.[1]

ADOPTION OF UNEMPLOYMENT COMPENSATION

BESIDES INITIATING or expanding the various services described briefly in the foregoing pages, the Social Security act as an omnibus measure contained one scheme for federal–state coöperation which did not use the familiar grant-in-aid device. Instead, the adoption of unemployment compensation by the states was stimulated by use of the tax-offset. The reasons which led to adoption, and the relative merits and defects of this technique, will be the principal topics of what follows.

Public action about unemployment compensation had been delayed in the United States by the same forces which held back other types of social legislation. Industrialism came relatively late, and after its arrival opportunities for employment were so plentiful that unemployment was not felt to be an acute problem. The labor movement had no great force and it was, in any case, not well disposed toward government action. Only in Wisconsin was there any evidence of sustained interest in unemployment compensation during the 1920's; and although the depression aroused isolated and sporadic efforts in other states—Governor Roosevelt of New York asked for legislation in 1930—few among its advocates expected federal action. So long as the federal government disclaimed any financial responsibility for unemployment, it could hardly be expected to act concerning unemployment compensation. Even those who argued that unemployment was a federal responsibility were disposed to admit that the constitutional barrier blocked federal action, at least until the states

[1] *Steward Machine Co.* v. *Davis,* 301 U.S. 548 at 587.

had shown the way. And here was the rub, because each of the states was afraid to act ahead of its neighbors. If the cost of unemployment compensation were put upon industry in state A, might not that lead to migration of industry or loss of markets to state B? It seemed, therefore, that unemployment compensation would fail of state action because the states, possessed of the constitutional power, feared to impair their competitive position; and it would fail of federal action because of a possible defect of constitutional power and of the will to move.

After 1933, when it appeared that the federal government was prepared to break with precedent on a broad front, the tone of the debate gradually changed. For the first time advocates of a purely federal scheme of unemployment compensation came forward and received a hearing. These people, familiar with foreign experience and disinclined to admit either the constitutional difficulty or the problems of a federalism, urged bold action. Unemployment as a problem cut across state lines and if left in the hands of the states, even with federal coöperation, it might be badly handled. There would be a variation in benefits and waiting periods, uneven administration, a complicated technique of finance, a failure to cover interstate employees.

But the great majority of the supporters of unemployment compensation felt that advocacy of a purely federal plan was both visionary and impractical. It assumed that we knew in detail what was wanted and what would work in the United States, whereas in fact the experts differed widely in opinion. It overlooked the existence of heterogenous states which were bound to feel that some variation in benefits and waiting periods was desirable, and that a complete pooling of reserves was unfair. It forgot that a centralized administration might, through bureaucracy and inflexibility, be at least as destructive of efficiency as would the unevenness of administration of a federal–state scheme. Political strategy had also to be considered. Congress might well balk at enactment of a purely federal scheme and yet be converted to acceptance of a scheme which was less out of line with precedent and which, therefore, aroused less opposition. And finally, almost everyone in 1934 was convinced that a purely federal measure would be thrown out by the Supreme Court.

If, then, the practical method of securing unemployment compensation was through some method of federal–state coöperation,

what were the alternatives? Opinion soon crystallized around two plans: one, embodied in the Wagner–Lewis bill which was before Congress in 1934 and which had been widely endorsed, depended upon use of the tax-offset; the other relied upon the technique of the grant in aid. Both of these plans aimed at removal of obstacles to state action and a similar pattern of legislation might well have been traced from either of them. Actually their proponents were prepared to trace dissimilar patterns and they therefore fell into acrimonious debate. Their differences of opinion centered around the proper amount of centralization which a scheme of unemployment compensation should contain, with the supporters of grants desirous of more, and the supporters of tax-offsets desirous of less, federal control.

The grant-in-aid plan for unemployment compensation was, in brief, that the federal government should collect a payroll tax, uniform throughout the nation, and return the appropriate amount as a 100 per cent grant to states which enacted legislation conforming to the standards set by the federal act.[2]

By the Wagner–Lewis bill there was similarly to be a federal payroll tax, but when a state passed an unemployment compensation act conformable to certain standards, the amounts paid by employers as contributions under this state act would be credited against the federal tax. Thus employers in a state with unemployment compensation would pay in no more than those in a state without. In the former case, although both a federal and a state tax would be levied, only the state tax would be a net charge; in the latter case, one tax alone would be paid.

It might seem that the difference in principle between the two plans was not great, and that the federal government could as readily specify conditions under the one as the other. The ultimate penalty utilized in enforcing conditions under a grant plan is withholding of the grants; the analogous penalty under an offset plan is refusal to credit the employers' contributions against the federal payroll tax. Possibly the grant plan has, in this respect, somewhat less awkwardness than the offset plan, but the inherent differences would appear to be slight.

[2] To describe this as a grant plan is to overlook one important difference from the usual plan. In the ordinary case the money distributed as grants comes from the general revenue, while in this case the money was to come from a special payroll tax, the proceeds of which were to be returned to the states.

It happened, however, that in the actual Wagner–Lewis bill very few federal conditions were specified—fewer than many advocates of unemployment compensation thought desirable. Therefore those who favored "more national standards as a minimum basis for State laws" turned to the grant plan.[3] It was, moreover, argued that a grant plan rested upon a more secure basis of constitutionality than did the tax-offset. The tax-offset or "credit" was inspired by its earlier and successful use in death taxation. The federal revenue act of 1924 gave a credit for state death tax payments up to 25 per cent (later 80 per cent) of the payments due under the federal estate tax, the effect of which was to neutralize the competitive advantage which a state might hope to gain by abolishing its death taxes. This had stood a test before the Supreme Court and the same device was now utilized in the Wagner–Lewis bill. Offsets against a federal payroll tax were parallel to offsets against a federal death tax. But clearly, if other conditions were added, the principle was being broadened and there was a danger that the Supreme Court would not accept the precedent. On the other hand, the advocates of the grant plan declared that it was supported by more extensive precedents and was less vulnerable to constitutional attack.

This argument, although suppositious, was not unreasonable; but a candid survey of legislative prospects must cast doubt upon the belief that at this time Congress was inclined to attach many conditions to any sort of social legislation. As has already been recounted, it struck out several modest restrictions upon state sovereignty suggested in connection with the old-age assistance features of the Social Security act, and the conclusion seems indicated that a similar fate would have awaited any attempt to impose strict federal conditions in connection with unemployment compensation.

Another consideration which weighed strongly with the supporters of the grant plan was that, looking to the future, it was almost

[3] Dr. Frank P. Graham, who was chairman of the advisory council to the Committee on Economic Security, testified: "I would say that the Advisory Council stood for writing into the Federal law more national standards as a minimum basis for State laws. I would favor national standards with regard to waiting period, rate of benefits, and duration of benefits to prevent unfair competition and to secure protection of the workers." U.S., 74th Congress, 1st session, Senate Hearings before the Finance Committee, Social Security Act, p. 293. The advisory council by a vote of 9–7 favored the grant basis.

certain to bring an increase in federal expenditure for unemployment compensation and a federal contribution outside the original payroll tax.[4] In short, the grant plan offered more opportunity for successful pressure upon the federal government to liberalize the original scheme of unemployment compensation. While the supporters of the offset plan admitted this possibility, they did not regard it as an advantage. On the contrary, they declared that the protection which their plan gave *against* pressure for increased federal expenditure was a strong argument in its favor. When benefits were paid directly from state funds and not from the federal treasury, pressure groups would be frustrated. Thus here again the basic difference between the disputants lay not in the technique which they favored, but in their attitude toward federal participation.

Two tactical considerations weighed in favor of the offset plan. First, the Wagner–Lewis bill had been before Congress and the public, it had received favorable attention, and it had, therefore, the advantage of an early start. Second, the tax-offset plan offered the prospect that, even if the constitutional hurdle were not surmounted, unemployment compensation might survive. Suppose, as was to be expected, that the states promptly enacted state laws in response to the federal stimulus whether given by grants or tax-offsets. Suppose, further, that after two or three years the federal statute were held to be unconstitutional. Under the grant plan the state statutes would be suddenly deprived of their support, since they would have no sources of revenue of their own. But under the offset plan, the state taxes would remain in operation and it might be hoped that the whole structure of unemployment compensation would not fall to the ground.

It cannot, however, be stressed too strongly that behind the sharp debate that went on between the two groups was a difference of opinion as to the type of unemployment compensation which was desirable. One group felt that it knew what should be done and that national standards about reserves, employer contribu-

[4] As Abraham Epstein put it: "The Federal Government has a chance, some day when you are rich and you have other moneys—suppose you reach the conclusion that you cannot levy more than 3 or 5 per cent on the employers, that still does not meet your whole problem—you say to the States, 'we will give you a few more dollars and you can raise your standards to 26 or 30 weeks to give these benefits.' " U.S., 74th Congress, 1st session, Senate Hearings before the Finance Committee, Social Security Act, p. 503.

tions, waiting periods, benefits, etc., should be established. The other group insisted that there were genuine and reasonable differences of opinion about many of these subjects; that something could be said in favor of the Wisconsin plan, the Ohio plan, and the other plans; and that only by permitting state variation and experimentation could we get answers as to which was best.

The Committee on Economic Security favored use of the offset approach, and therefore the bill which came before Congress resembled, with respect to unemployment compensation, the earlier Wagner–Lewis bill. There was, however, one alteration which reflected the current criticisms. Instead of providing, as had the Wagner–Lewis bill, for a complete offset against the federal tax, the plan now was that state collections were to be credited up to 90 per cent of the federal tax, while the remaining 10 per cent was to be paid into the federal treasury. This revenue was, however, to provide grants to the states to cover the cost of administration of unemployment compensation, although it was pretended, for constitutional reasons, that the federal collections (under Title IX of the bill) and the general grants for administration (under Title III) were unrelated. This change grew out of a realization that some additional method was desirable by which federal supervision might be strengthened. If the federal government assumed the cost of administration by providing grants, it might also set up conditions for receipt of the grants which would tighten federal controls.

The Committee on Economic Security declared also that the federal government should assume certain minimum responsibilities. Approximately a uniform rate of contribution by employers was essential in order to avoid destructive competition between the states, and this was to be taken care of by the offset plan; safeguard of the large reserve funds should also be the job of the federal government because it alone had a credit standing which would insure the solvency and liquidity of the funds in bad times and because control over the reserves should naturally be handled by the government which had control over monetary policy. For the rest, however, the Committee was inclined to leave wide discretion and responsibility to the states "so that we may learn through demonstration what is best." It dismissed the current controversies over unemployment compensation as aca-

demic, expressing the belief that "what is needed at this stage is demonstration, not further debate and research." [5]

The unemployment compensation provisions of the social security bill followed the recommendations of the Committee and it would not be profitable to follow the prolonged debate over certain features. There was, for example, a controversy over pooled reserves *vs.* plant reserves or industry reserves. Against those who wished to sanction only pooled reserves were arrayed those who pointed out that this would be to invalidate the unemployment compensation acts already passed by three states—Wisconsin, Utah, and New Hampshire. Wisconsin in particular had strong feelings about the desirability of experimentation with plant reserves. And the Supreme Court strengthened the hands of those who argued for a minimum of federal conditions when, on May 6, 1935, while the social security bill was still in the legislative process, it held the railway pension act to be unconstitutional because, among other things, it violated due process by pooling reserves.[6] This seemed to be a warning not only against pooled reserves but against an overstrict federal act.

The desire of the Committee on Economic Security to give the states a "broad freedom" to frame unemployment compensation laws and to leave to them "all matters in which uniformity is not essential" [7] met a ready response in Congress. Indeed Congress, and especially the Senate, was more tender of state sovereignty than the Committee. Thus the original bill had stated, as a condition of receiving grants for administration, that all positions in the administration of state unemployment compensation laws were to be "filled by persons appointed on a non-partisan basis, and selected on the basis of merit under rules and regulations prescribed or approved by the Social Security Board." During the Senate Hearings the following passage occurred:

> Senator King. You attempted did you not, Doctor, in the drafting of these provisions of the bill, to recognize the fact that the States did have some rights?

[5] Report, p. 15.

[6] *Railway Retirement Board* v. *Alton Railway Co.*, 295 U.S. 330. It was a violation of due process to "disregard the private and separate ownership of the several respondents, treat them all as a single employer and pool all their assets regardless of their individual obligations and the varying conditions found in their respective enterprises. . . ."

[7] Report, p. 20.

Mr. Witte. That is the essential purpose of it.

Senator Byrd. You recognize the rights of the States to start with but you give your Board power to veto what the States have done?

Mr. Witte. On this matter of standards to be prescribed our recommendations will be criticized, as they have already been criticized before you, on the ground that the standards are too few, and they will be criticized on the ground that the standards are too many. What standards shall be prescribed is, of course, a matter for the decision of the Congress.[8]

The outcome of this sentiment was that the condition cited above was removed and as a substitute it was declared that

the Board shall make no certification for payment to any State unless it finds that the law of such State . . . includes provisions for—(1) Such methods of administration (other than those relating to selection, tenure of office and compensation of personnel) as are found by the Board to be reasonably calculated to insure full payment of unemployment compensation when due. . . .[9]

In short, the Board was *denied* the right to make conditions about "selection, tenure of office and compensation of personnel." The conclusion is unavoidable that Congress was disinclined to strengthen the federal power beyond the indispensable minimum. The very passage of the Social Security act meant, to be sure, the assumption of new federal responsibilities and that was felt to be sufficiently revolutionary without building up federal domination of the administrative machine.

The unemployment compensation provisions of the Social Security act provided, then, for a federal payroll tax upon employers of eight or more employees in covered industries beginning at the rate of 1 per cent in 1936, rising to 2 per cent in 1937, and to 3 per cent for subsequent years. In a state which enacted a scheme of unemployment compensation conformable to specified requirements and approved by the Social Security Board the employers could offset their state contributions up to 90 per cent of the federal tax for a year. All the money collected under the state laws has to be paid into the treasury of the United States, where a trust account is established to the credit of the states. As has already been noticed, the federal government, through the Social Security Board, also provided grants to cover the total cost of state administration, and by attaching conditions to these it was

[8] U.S., 74th Congress, 1st session, Senate Hearings before the Finance Committee, Social Security Act, p. 222.

[9] Section 303 (a).

hoped that an efficient state administration would be built up. Congress had unfortunately forbidden the Board to prescribe about state personnel, but otherwise it left a wide discretion as to the amount of the grants to be given to any state.[10] Further conditions prescribed in the act cannot be discussed here, but it is pertinent to notice that the states were required to make payment of unemployment compensation solely "through public employment offices . . . or such other agencies as the Board may approve."

Unemployment Compensation in Operation: Constitutionality Upheld

Not much time was required to demonstrate that some of the fears expressed in 1935 by critics of the schemes of unemployment compensation were unfounded. It had, for example, been prophesied that the device of the tax-offset would be ineffective to induce a response by many of the states.[11] Yet, by the middle of 1937 all the states and territories had rushed into the scheme, and therefore the success of the tax-offset as a stimulant exceeded the expectations of its proponents. It will be recalled also that in 1935 constitutional fears about unemployment compensation were widely expressed and for this reason, among others, few federal standards and conditions were put in the federal act. This also was sharply criticized by those who felt that a purely federal scheme was desirable and who, as a second-best choice, were willing to endorse a federal–state plan only if it were set up with basic federal standards so that, at some later time, conversion to a federal scheme could be readily accomplished.

The hurdle of unconstitutionality was surmounted on May 24, 1937 by the narrow margin of a 5–4 decision of the Supreme Court.[12] The most important issue for our purposes was that of state sovereignty. Justice Cardozo who spoke for the majority declared: "It is too late today for the argument to be heard with tolerance that in a crisis so extreme [as that after 1929] the use

[10] The Board is to consider population, the number of persons covered by the state law, the cost of proper administration, and "such other factors as the Board finds relevant." Section 302 (a) (3).

[11] U.S., 74th Congress, 1st session, Senate Hearings before the Committee on Finance, Social Security Act, p. 1008: statement of Dr. E. M. Burns.

[12] *Steward Machine Co.* v. *Davis,* 301 U.S. 548.

of the moneys of the nation to relieve the unemployed and their dependents is a use for any purpose narrower than the promotion of the general welfare." Unemployment was a national problem and this act was designed not to coerce the states, but to give them a larger freedom in joining together to avert a common evil. The conditions imposed upon them were basic and essential, rather than arbitrary.

> A wide range of judgment is given to the several states as to the particular type of statute to be spread upon their books. For anything to the contrary in the provisions of this act they may use the pooled unemployment form, which is in effect with variations in Alabama, California, Michigan, New York, and elsewhere. They may establish a system of merit ratings applicable at once or to go into effect on the basis of subsequent experience. They may provide for employer contributions as in Alabama and California, or put the entire burden upon the employer as in New York. They may choose a system of unemployment reserve accounts by which an employer is permitted after this reserve has accumulated to contribute at a reduced rate or even not at all. This is the system which had its origin in Wisconsin. In determining essentials Congress must have the benefit of a fair margin of discretion. One cannot with reason say that this margin has been exceeded, or that the basic standards have been determined in any arbitrary fashion.[13]

Justice McReynolds was of a very different mind. He felt that the majority decision opened the way for the "practical annihilation" of state freedom and "no cloud of words or ostentatious parade of irrelevant statistics should be permitted to obscure that fact." And Justices Sutherland and Van Devanter, while making a different approach, felt that by certain provisions of the act

> the federal agencies are authorized to supervise, and hamper the administrative powers of the state to a degree which not only does not conform with the dignity of a quasi-sovereign state—a matter with which we are not judicially concerned—but which deny to it that supremacy and freedom from external interference in respect of its affairs which the Constitution contemplates—a matter of very definite judicial concern.[14]

[13] *Ibid.*, at p. 587.

[14] *Ibid.*, at pp. 613–14. It appears that Justices Sutherland and Van Devanter would have been more lenient in their attitude to grants as a device (p. 612), although not to the imposition of conditions. Justice Butler in a separate opinion expressed agreement with the dissents of Justices McReynolds and Sutherland. On the same day and by the same vote, the Supreme Court upheld the constitutionality of the unemployment compensation law of Alabama, which was of the pooled type. *Carmichael* v. *Southern Coal Co.*, 301 U.S. 495.

It would, therefore, seem that the extent of the federal conditions and controls weighed heavily in the decision of the Court. A minority felt that these were too many; a bare majority felt that they were reasonable and not excessive. One cannot be sure what would have happened to a stricter federal act, but surely there is reason to guess that it might have received a judicial veto. Quite apart from the question of whether or not state experimentation was desirable, the caution exercised by the framers of the Social Security act in drawing up a plan of unemployment compensation appears commendable. A federal–state scheme was actually put into effect and it was not upset early in its history by an adverse court decision.

The Recession in 1937

The laws enacted by the states in response to the stimulus of the tax-offset did show considerable variety. Seven states (Wisconsin, Nebraska, Kentucky, South Dakota, Oregon, Indiana, Vermont) made provision for separate employer reserves and forty-four for state pooling; but of the forty-four, thirty-three had some sort of merit rating.[15] Workers' contributions were required in many of the early state laws, but a drift away from this soon set in and by 1941 only five states were making collections. There was, besides, diversity in coverage, benefit provisions, and in many minor provisions of the state laws.

Before the system had a chance to settle down, the sharp recession of 1937 struck the nation, and unemployment compensation as a first line of defense was put to the test. Unquestionably there was confusion, delay, and disappointment; yet it would be wrong to fasten the major blame upon unemployment compensation, or indeed upon any one aspect of the federal program. An array of agencies had been set up in a short time, some designed to meet immediate and pressing social problems, others with an eye to the long future, but in all cases without careful integration. The relationship between unemployment compensation and the employment service, between work relief, direct relief, and unemployment benefits had not been worked out. Unemployed

[15] Ten laws provided for a study of the principle of adjusted compensation rates, and only one state, Pennsylvania, had a pooled fund "with no provision for application or study of experience rating." Annual Report of the Social Security Board, 1939, p. 67.

workers were sometimes in need before they were in receipt of benefits and the amount of these benefits was often so small as to be by itself entirely inadequate. The administrative relationships between the different agencies were so tenuous that a man in receipt of inadequate benefits might be ineligible for work relief or even for direct relief. The simple fact is that the recession had taken everyone by surprise and that the elaborate machinery to handle unemployment did not mesh. Only two years had elapsed since the basic federal legislation had been passed and an even shorter time since the passage of most of the state unemployment compensation laws. The task of recruiting personnel and building up an administrative organization was enormous, especially when it is remembered that a trained personnel did not exist in the United States. To all this was added the bad luck of having the unemployment benefits of twenty-two states become payable in June 1938, at a time of heavy unemployment. To fasten particular blame upon the divergent provisions in the state unemployment compensation laws, or upon any other features of the federal–state relationship, or to argue that a straight federal system of unemployment compensation would have stood up better, is an error. A purely federal system would have broken down under the impact of administrative difficulties which the federal–state system at least handled with limping success.

Current Federal–State Issues

This is no place for a discussion of the many technical problems arising in connection with unemployment compensation, and only a few which reflect the federal–state relationship will be touched upon. The coverage of the state laws is quite uniform with respect to the industrial groups included and excluded; but there are many differences in actual coverage, since the size of the firm included—as measured by the number of employees—is not the same from state to state. Thus twenty-five states following the lead of the federal government, make firms with eight or more employees subject to their laws, while seven reach firms with only a single employee. The Social Security Board has favored the removal of the restriction in the federal act to employers who have eight or more employees, although so far Congress has not responded. The Board has also recommended that

coverage be enlarged,[16] and again Congress has held back. Undoubtedly, however, there will be a swing toward a more extended coverage as administrative problems are cleared up.[17]

The issue of merit rating is still very much alive, with a sharp difference of opinion as to its desirability. Merit rating is a distinctive feature of American, as distinct from European practice, and the origin of the idea is to be traced to experience with workmen's compensation. Opponents of the device insist that there is no analogy—that while the individual employer may be stimulated by workmen's compensation to the introduction of safety devices, he cannot be similarly stimulated by merit rating toward stabilization of employment. Supporters insist that employers do have some control over the amount of employment. No definitive settlement of the dispute is possible, and one may agree that "the prospect of worth-while results is at least sufficient to indicate that merit [i.e., experience] rating should receive a thorough test." [18] Certainly the states in their laws have shown a partiality toward merit rating, and their enthusiasm has brought a danger of interstate competition because provisions for a lower rate of contribution by employers with good records have not generally been offset by higher rates for employers with poor records. In short the very danger which the uniform federal tax of 3 per cent of the Social Security act was designed to remove may come back in the guise of merit rating.[19] It would be alarmist to regard this

[16] Proposed Changes in the Social Security Act, A Report of the Social Security Board to the President and to the Congress of the United States, January, 1939, pp. 16–18. Congress in 1939 did amend the act so as to bring employees in certain governmental instrumentalities such as national banks, state member banks, and federal building and loan associations under unemployment compensation.

[17] One obvious anomaly in the original act was that while under old-age insurance the federal payroll tax on employers was limited to the first $3000 a year paid to an employee, that under unemployment compensation was levied on the total amount paid out in wages and salaries. This made for burdensome and confusing reporting, and in 1939 when the Board recommended a uniform tax base—the first $3000 of annual wages—its recommendation was enacted by Congress.

[18] W. Matcheck and R. C. Atkinson, *Problems and Procedures of Unemployment Compensation in the States* (Chicago, 1939), p. 62. These authors say also: "The widespread differences [in Wisconsin] in benefit payment experience among concerns in the same industry would seem to increase the possibility that merit rating might exert a significant influence for stabilization." *Ibid.*

[19] U.S., 76th Congress, 1st session, House Hearings before the Ways and Means Committee, Social Security Act Amendments of 1939, testimony of Mr. Altmeyer, p. 2366. See also R. C. Atkinson, *The Federal Role in Unemployment Compensation Administration* (Washington, 1941), pp. 143–44, and Eighth Annual Report of

tendency as an immediate threat, but adoption of unsound merit schemes may have to be checked by setting up conditions in the federal law.

The recession of 1937–38 also raised a sharp debate about benefits and contributions. It was inevitable that a uniform rate of contribution would not make possible the same level of benefits over the nation because the unemployment records of the states differed very substantially. This variation was strikingly displayed in 1938, with the result that, while in some states the solvency of the reserves seemed to be endangered, in others the reserves piled up and brought agitation for reduction in the contribution.

> There were 13 States in which benefit payments during 1938 were equal to, or in excess of, the amounts collected in contributions from the date benefits were first payable. In one State the benefits paid out were nearly three times the contributions collected during the period benefits were paid. That is Michigan. In two States, if they had begun to pay benefits in January, 1938, instead of July, 1938, their unemployment compensation funds would now be nearly exhausted.[20]

With the improvement in business, however, reserves again began to mount and in many states an agitation for a reduction in contribution got under way. Most of the states, following the early advice of the Committee on Economic Security and the Social Security Board itself, set up conservative scales of benefits and waiting periods. The usual benefit was 50 per cent of the weekly wage loss with a maximum limitation of $15 per week and a period during which benefits were payable of 14 to 16 weeks. The waiting period usually ran 2 to 3 weeks. The experience of 1938 seemed to indicate that these relatively illiberal provisions were prudent, but the more favorable trend of employment since then would permit some states to be more generous than they have been. Certain states with large reserves ought to reduce the waiting period, provide a substantial minimum benefit,

the Social Security Board, p. 29. In 1941, in the seventeen states which had merit (experience) rating, the employer contributions were from 1.3 per cent to 2.6 per cent of payrolls and averaged 2.1 per cent; in 1942, in the thirty-four states which had merit rating, the contributions were from 1.0 per cent to 2.7 per cent and averaged 1.7 per cent. Thus the rate of contribution has declined at a time when employment and payrolls were at record levels.

[20] U.S., 76th Congress, 1st session, Senate Hearings before the Finance Committee, Social Security Amendments, 1939, testimony of Mr. Altmeyer, p. 25.

increase the benefit rate and the duration of benefits, before they contemplate a reduction of contributions. Unfortunately some of the states cannot afford liberalization, and therefore the federal government could not push *all* the states toward liberalization without special federal subsidization.[21]

THE GRANTS FOR ADMINISTRATION

Let us look for a moment at the administration of unemployment compensation. An unusual feature here is that the federal government makes 100 per cent grants to the states to cover the cost of administration. At the very outset it was realized that these had to be handled with special care. The states could not be left free to spend the grants for administration as they pleased, else careless spending would be certain. The Social Security Board had been given considerable powers of control since the act declared that it could apportion the grants to the states using as a basis population, the number of persons covered by the law, "the cost of proper administration," and such other factors as it found relevant. As a check, however, it was debarred from interference "relating to selection, tenure of office, and compensation of personnel." [22] Determined to avoid the scandal which would grow out of waste of federal money, the Board at first required detailed quarterly budgets from the state agencies and maintained a meticulous supervision over expenditure. Beyond question this was necessary in the early stages of unemployment compensation,[23] yet it led to bickering with the states over petty matters and forced all the states into a complicated routine which was appropriate only for those which were inclined to abuse their position. The Board in 1938 decided to relax the rigor of its early requirements by developing "objective standards" [24] for measuring administrative costs, and in states with established civil service

[21] See pp. 209–233 of the Senate Hearings for a statement of P. A. Raushenbush, director of the unemployment compensation department of Wisconsin, criticizing the proposal of imposing new federal standards. See Atkinson, *Federal Role in Unemployment Compensation Administration*, chapter ix, for the opposite argument and for suggestions as to methods of finance.

[22] The similar clause relating to old-age assistance has already been discussed.

[23] V. O. Key, *The Administration of Federal Grants to States* (Chicago, 1937), pp. 70–71.

[24] Annual Report of the Social Security Board, 1938, p. 44; *ibid.*, 1939, p. 44.

systems it agreed to approve categorical amounts for salaries and wages without detailed budgeting.

Then in 1939 the Board requested Congress to repeal the clause in the act which restricted interference with personnel and to authorize it to require the states to establish and maintain "personnel standards on a merit basis." Congress agreed to both requests and the Board believes that this will "eliminate the necessity for detailed Federal scrutiny of operation and the possibility of misunderstanding and conflict in Federal–State relations." [25]

Beyond question the unusual device of the 100 per cent grant has achieved some desirable results. Along with the tax offset, it helped spur the states into acceptance of unemployment compensation. By it the Board has been able to enforce a more detailed supervision of state administration than would have been possible through use of the matching grant. Again, the 100 per cent grant enables the Board to equalize the financing of state administration. The populous industrial states have lower costs than the sparsely settled, agricultural states and it would have been difficult to frame a formula to take account of this variation. On the other hand, the 100 per cent grant puts upon the Board an exacting task which requires detailed scrutiny of state accounts and tends to bind all the state agencies by bureaucratic rules. Moreover, "to assign broad administrative authority to states without requiring them to bear a substantial part of the cost is anomalous and, in spite of federal efforts, potentially dangerous." [26] Some method which would require the states to provide part of the funds for administration seems, therefore, to be desirable.

The ultimate device placed in the hands of administrators of federal grants is withholding, and the Social Security Board on one occasion stopped the grants for administration of unemployment compensation to a state for nearly two months. The effect was almost to suspend the work of the state agency. Obviously stoppage of a 100 per cent grant is more drastic than stoppage of a grant which makes up a much smaller portion of state expenditure, and this means that exercise of it is bound to be restricted. The related device of refusing tax-offsets to the employers of a

[25] U.S., 76th Congress, 1st session, Senate Hearings before the Finance Committee, Social Security Act Amendments of 1939, p. 32.

[26] Atkinson, *Federal Role*, p. 52.

state has so far never been used, although the Board on several occasions has considered this step.[27] Here, as with other welfare expenditure, the severity and the oblique incidence of the penalty make it difficult of application in any other than extreme cases.

Proposals for Reform

Since 1935 the number of people who believe in a purely federal scheme of unemployment compensation has grown. The issue of constitutionality, which counted heavily in the original decision to establish a federal–state system, has now been removed. Moreover, the initial impact of administrative difficulties has been surmounted—doubtless with greater ease than by a federal scheme—and the experience which has been gained would be the basis for a federal scheme. The present system has already been breached by passage of the Railroad Unemployment Insurance act which puts railway workers under a separate and purely federal scheme, a step which has raised problems of coverage and has complicated the job of compliance for some employers.[28] The federal government, moreover, collects a payroll tax for old age and survivors' insurance and critics declare that to have two other payroll taxes for unemployment compensation, one collected by the federal government and one collected by all the states and territories, is to maintain a duplicate administrative system.[29] This criticism has some merit. Again, certain states are so small in population that they do not provide an efficient and low-cost administrative unit; for the fiscal year ending June 30, 1940, the administrative costs in North Dakota and Nevada were 24.5 per cent and 18.6 per cent of unemployment compensation contributions, compared with 5.3 per cent and 5.4 per cent for Illinois and Ohio.[30] It may, however, be doubted that the saving from federal administration would be great, because for the nation as a

[27] See Annual Report of the Social Security Board, 1939, p. 42, for instances involving Oregon and South Dakota.

[28] The Interstate Conference of Employment Security Agencies at its conference in 1939 passed resolutions condemning the trend away from the federal–state system.

[29] It should, however, be noticed that federal administration of taxes for unemployment compensation, unless accompanied by complete federal assumption of the whole job of handling the system, would bring no gains. See Atkinson, *Federal Role*, p. 125.

[30] *Ibid.*, p. 166.

whole the present direct administrative cost is reasonably low. Another objection to the present scheme is that a federal–state system creates difficulties in the handling of interstate workers, and again this criticism has some justice. But remarkable progress has been made at handling this problem by the Social Security Board and the Interstate Conference of Employment Security Agencies (formerly the Interstate Conference of Unemployment Compensation Agencies), and the gains which might be achieved by a federal system do not seem impressive.

The consideration which weighs most heavily with the supporters of a federal scheme is that thereby unemployment compensation would be liberalized. In many states benefit payments are too small, waiting periods are too long, and the duration of benefits is too short. Yet it was not unreasonable to assume in 1935 that states would do the best they could for their own workers, and it is not unreasonable to make the same assumption at present. In a few states the group which desires low benefits, etc., will be stronger than in others, but the long-run danger that not enough will be spent so long as the money is there seems unrealistic. It is, however, proper to point out that in some states the present contributions will not permit more adequate payments to the unemployed, while in others they will. A uniform rate of contribution, specified by federal law, is both overadequate and underadequate because of differences of the volume of unemployment in the different states. From January 1938 to June 1939 Oregon paid out 93.6 per cent of its receipts, while California paid out only 43.7 per cent; Rhode Island paid out 104.5 per cent, and Massachusetts only 68.2 per cent. It appears unfair that workers similarly situated except as to state of unemployment should be dissimilarly treated with respect to payments for unemployment.

Possibly the best remedy for this diversity is federalization.[31]

[31] A summary argument in favor of federalization is presented in *Security, Work, and Relief Policies, 1942,* the report of the committee on long-range work and relief policies to the National Resources Planning Board (Washington, 1942), pp. 536–37. The Social Security Board itself has come out strongly for federalization. In the report for 1943 it said: "Incorporation of unemployment compensation in a unified national scheme of social insurance would result . . . in a program far safer, stronger, and more nearly adequate from the standpoint of unemployed workers and the Nation, and would permit more economical and effective methods of administration" (p. 37).

At present it is certain that the full force of the states' rights sentiment will be

Other less far-reaching proposals might, however, achieve a reasonable solution of present difficulties. These contemplate imposition of federal standards upon the states with respect to benefits, etc., together with a plan of "reinsurance." Minimum benefit standards would secure some uniformity in the pattern of benefits from state to state, and it would prevent reduction in the payroll tax through payment of unduly low benefits. Some states, however, would find that the minimum benefits set by federal legislation cost *more* than they collect by a tax of 2.7 per cent, and here the remedy might be to permit them to draw upon a special federal reserve fund. How might this fund be built up? One suggestion is that a 2 per cent, instead of a 2.7 per cent, offset be specified for state payroll taxes. In this case the federal government would collect 1 per cent for unemployment compensation, rather than $\frac{3}{10}$ of 1 per cent as at present. The federal fund would, in effect, be an equalizing device designed to support the weaker states.[32]

The federal–state coöperative scheme in the handling of unemployment compensation—and to some extent in public assistance—has made one important contribution toward improvement of government in the United States which might be lost or impaired by a too early substitution of a federal for the federal–state scheme. There is clear evidence that, since 1935, state personnel and state administration have been improved in very many respects. Standards and regulations imposed by the Social Security Board on agencies with which it had direct relations have often been extended into other branches of state government. It may be that these gains would not be lost if the federal–state relationship in unemployment compensation were severed, but until the merit system for state personnel has a stronger hold, the danger of reversion is appreciable.

Employment Offices

During World War I the federal government, in order to meet war needs, spread employment offices over the nation on a purely

thrown against federalization. What was thought to be a threat against the present scheme in 1942 led to a violent protest (see U.S., 77th Congress, 2d session, House Hearings before the Ways and Means Committee on H.R. 6559, War Displacement Benefits).

[32] See Report of the Interstate Conference of Employment Security Agencies, 1941, address by George E. Bigge; Atkinson, *Federal Role*, p. 183.

federal basis. In 1918–19 federal appropriations for operation of the offices amounted to $5,722,000.[33] But because of public inertia and Congressional opposition, the service shrank almost as fast as it had grown and the field was left mainly to the states and to private agencies. Even the state offices declined in number and by the end of 1930 there were only 151 offices in some twenty-four states. "Offices frequently consisted of one agent and a clerk; they were often poorly located and lacked the confidence of employers and employees." [34]

The depression naturally aroused new interest and in 1931 Congress passed a bill (the Wagner bill) providing for a federal–state system with federal grants of $4,000,000 a year. Unfortunately the bill was vetoed by President Hoover who expressed a preference for extension of the existing skeleton service on a federal, rather than on a federal–state basis.[35] Extension of the United States Employment Service was begun, but because of haste and "politics," the job was badly done.

> The Department of Labor practically ignored the existing state employment services, the good as well as the poor, and located more than a third of its offices in places where state agencies already existed. . . . Had the federal offices represented a substantial improvement over those maintained by the states, much might have been said in behalf of the new program even though it involved needless duplication of facilities; but investigation has shown that the offices were organized with inadequate consideration of employment service needs and that the personnel was largely selected on a political basis.[36]

Here then was a strictly federal scheme which was utterly ineffective.

The fiasco of this so-called "Doak reorganization" turned Congress back to the earlier proposal of a federal–state scheme and in 1933 the Wagner–Peyser act was passed which provided for federal grants in aid to state employment offices. The appropriation for grants of $1,500,000 for the first year and $4,000,000 a

[33] *Social Security in America* (Committee on Economic Security, Publication No. 20, 1937), p. 428.

[34] Bitterman, *State and Federal Grants-in-Aid,* p. 339; Atkinson, Odencrantz, Deming, *Public Employment Service in the United States* (Chicago, 1938), p. 19.

[35] See R. M. Kellogg, *The United States Employment Service* (Chicago, 1933), pp. 63–69.

[36] Atkinson, Odencrantz, Deming, *Public Employment Service,* pp. 20–21.

year for the next four years was to be distributed to the states on the basis of population with the requirement of state–local matching.[37] A new United States Employment Service was set up with considerable powers of supervision and with authority to establish federal offices in states which refused to coöperate. By June 30, 1934, eighteen states, and by 1939, all the states were in the scheme.

Almost from the beginning the activities of the Employment Service were affected by the multitude of new jobs being done by Washington. First the Service had to recruit labor for PWA, and as a result a National Employment Service was set up, financed and administered by the federal government. Then in turn came CWA and WPA, with consequent expansion of the staff of this emergency organization. But as the states organized their employment offices, those of the National Employment Service were curtailed or absorbed. Meanwhile, the Social Security act had been passed in 1935 and the form which it took with respect to unemployment compensation was influenced by the prior existence of the Wagner–Peyser act. Employment offices are a necessary part of the machinery for the payment of unemployment benefits, because only by having the unemployed register at an employment office and accept work if it is available can there be a check upon malingering. Enactment of a system of unemployment compensation on a purely federal basis would have compelled the conversion of the existing offices from a federal–state to a federal basis, and this seemed inadvisable at a time when the memory of the "Doak reorganization" was clear.[38] The Social Security act accordingly specified that payment of benefits for unemployment compensation through state employment offices was acceptable; and the Social Security Board after its appointment determined to approve of no substitute, although it had not the legal authority to require the states, as a condition to receipt of grants for the administration of unemployment compensation, to affiliate with the United States Employment Service. It was, however, able to accomplish this in effect by requiring that states, which were not under the Wagner–Peyser act and which had to expand their

[37] By amendment in 1935 the minimum federal grant for a state was set at $10,000.

[38] P. H. Douglas, "The Development of a System of Federal Grants-in-Aid," *Political Science Quarterly*, 1920, p. 32.

employment services, should put up sums for this purpose equal to those required under the Wagner–Peyser act. The result was to push into the United States Employment Service the few states which were still outside.

There was, however, an awkward problem in finance and in administration on the *federal* level. The employment service had naturally to be greatly expanded in order to handle unemployment benefits, and the financing of this part of the work was met by 100 per cent grants from the Social Security Board, whereas the original duties of the service were financed on a 50–50 basis as provided in the Wagner–Peyser Act. Before long about 80 per cent of the total cost of operating the service came from the Board, the remaining 20 per cent being split between the states and the federal government. Thus a dual system of finance prevailed on the federal level, and also a dual system of supervision, since both the United States Employment Service and the Social Security Board were concerned with the activities of the state–local offices. The frictions and duplications inherent in such a set-up were so numerous that the Board and the Secretary of Labor (the U.S. Employment Service was in the Department of Labor) in 1937 created a coördinating committee [39] to secure integration of administration on the federal level. This was a forward step, but some duplication and delay continued,[40] and in 1939 the Board recommended "that the administration of unemployment compensation and of the United States Employment Service be unified in a single Federal bureau . . . in the interests of economy, efficiency and good-will." As to whether it or the Department of Labor should be given control, the Board was silent, but Congress transferred the service to the Board, effective

[39] Atkinson, Odencrantz, Deming, *Public Employment Service,* p. 80.

[40] As Mr. Stead, director of the United States Employment Service, pointed out, "It is required under the present agreement that there be two audit reviews, two field reviews, and two decisions with respect to Employment Service budgets, because there is federal money coming from the Wagner–Peyser act, by direct grants from Congress, and there is Social Security money going into the Employment Service. I think the greatest element of difficulty and delay can be eliminated by the clearing up of the fiscal arrangements." U.S., 76th Congress, 1st session, House Hearings before the Ways and Means Committee, Social Security Act Amendments of 1939, p. 2154.

July 1, 1939.[41] Beyond a doubt this was wise, and both improvement and simplification of administration have resulted.[42]

The war brought federal assumption of the state employment services. On December 19, 1942, the president called upon the governors to turn over these services in order to secure national organization of the labor market for the emergency, and on January 1, 1942, the Social Security Board took over operation, transferring the state employees to the federal service.[43] Forecasts that this step will result in federalization of unemployment compensation have been ventured, and state administrators of unemployment compensation have certainly indicated a fear that this may happen.

If unemployment compensation should be federalized, then federalization of the public employment service will be a necessary accompaniment. Even if the larger move is delayed by the public sentiment against extension of federal controls, federalization of the employment service should serve as a desirable prelude.

[41] The Department of Labor was not in favor of this change. In testimony before the Ways and Means Committee (76th Congress, 1st session) on the Social Security Act Amendments of 1939, p. 2152, the following occurred:

"Mr. McCormack. Suppose there is unification and consolidation of both, I presume that it is the attitude of the Department of Labor that the Employment Service belongs with the Department of Labor.

"Mr. Dimock (2nd Assistant Secretary of Labor). You are correct in that.

"Mr. McCormack. And that under no conditions should the Wagner–Peyser Act, and the activities thereunder, be taken away from the Department of Labor.

"Mr. Dimock. That is right."

The reason given for this attitude was that placement work might suffer (p. 2157). But this argument has been criticized (pp. 2435–39) and it has been declared that the burden of work in offices dealing with unemployment compensation and also with placement is mutually compensating. In depression the unemployment compensation activities are naturally up and placement activities down; in prosperity the opposite. The staff of the offices needs shifting over time, with no hiring of new staff.

[42] The new Bureau of Employment Security resulted from the consolidation of the United States Employment Service and the Bureau of Unemployment Compensation.

[43] In September 1942 the employment service was transferred to the War Manpower Commission.

CHAPTER XII

PUBLIC DOMAIN

PUBLIC LANDS

In Europe the object is to make the most of their land, labor being abundant; here it is to make the most of our labor, land being abundant.

THOMAS JEFFERSON.

ALTHOUGH the original states, and Kentucky and Texas, were left in possession of the public lands within their borders, the federal government had a much greater responsibility. By cession of the western territories, and thereafter by the Louisiana Purchase, the Florida Acquisition, the Oregon settlement, and the Gadsden purchase, a vast domain not far short of 1½ billion acres came under federal control. Of this area 1,016,215,000 acres have been alienated in the following ways:

	Millions of acres
Homesteads	274.0
Cash sales and miscellaneous	418.0
State grants	230.0
Railway grants to corporations	94.2
	1,016.2

At present the federal domain contains approximately 430,300,000 acres, of which 210,100,000 are in national reservations,[1] while of

[1] Lands owned by the federal government, June 30, 1934:

		Millions of acres
Public domain		220.2
National reservations		210.1
National forests	145.8	
National park areas	9.3	
Wildlife refuges	1.9	
Indian lands	52.1	
Military and naval	1.0	
Total		430.3

Source: National Resources Committee, *Supplementary Report of the Land Planning Committee* (1935–1938), Part VII: "Certain Aspects of Land Problems and Government Land Policies," p. 88; *ibid.*, Part XI: "Recreational Use of Land in the United States," p. 82.

the remainder little is fit for settlement. It is unlikely that there will be any further net alienation of the domain. On the contrary, there is every prospect of slow accretion by reacquisition from private and state owners.

Federal disposal of the domain was in no way limited by constitutional restrictions. What was done was done in furtherance of national policies. This is not to say that the actual policy pursued has been unfaltering and unequivocal, since Congressional conception of what was a proper policy has shifted frequently in the past one hundred and fifty years. But until recently it is fair to say that behind all diverse federal legislation lay the deep conviction that the domain ought to pass from public to private hands because thereby a passive asset would be made active, settlement would be stimulated, and the national income would be increased. The homestead grants were the clearest expression of this belief, yet it should not be forgotten that in other alienations the purpose was similar. The grants to the railways, for example, were designed to tempt private capitalists to supply frontier regions with a type of capital equipment which was essential for permanent settlement; and it was hoped, besides, that the railway companies, in order to build up their own revenues, would do their best to place people on the land which they secured from the federal government.

To point out that federal policies about the domain were free from constitutional limitations is, of course, not to deny that they were subjected to steady sectional pressures with the result that seldom did any actual policy receive the whole-hearted endorsement of all the nation. The hope—indeed the expectation—of many statesmen in the early years of the Republic was that the domain would be an asset which, through gradual sale, might relieve the federal treasury from fiscal difficulties. Thus Jefferson in 1787 declared: "I turn to this precious resource as that which will in every event liberate us from our domestic debt, and perhaps too from our foreign one." For decades this notion was cherished, particularly in the seaboard states, and when their influence in Congress was great it found expression in legislation. But against it was arrayed the progress of settlement. In 1790 there were only 250,000 people, out of a population of 4,000,000, over the mountains. Each succeeding decade was, however, to see an extension of westward colonization, and as new states were

admitted to the Union the idea of using the domain as a major source of federal revenue and of promoting orderly settlement was subjected to successful pressure. In 1800 the revenue system became a credit system; in 1820, when that broke down, the price per acre (and the minimum acreage purchasable) was reduced; in 1841 general preëmption was legalized; and in 1862 the Homestead act was passed.

Debate over the wisdom of this trend never ceased. A few, of whom John Quincy Adams is representative, held to the original vision of planned settlement and conservation of a federal asset. Until the Civil War the attitude of many southerners reflected their views first about the tariff and second about slavery. Other easterners, together with some from the older western states, feared that the flow of population to the west would injure the value of their lands and impede the progress of their manufacturers. Against all of these the people of the west presented a united front. They repelled the idea that the western lands were a federal domain, holding instead—as Senator Benton put it—that "the public lands belong to the people, not to the federal government." After the Civil War there were few who ventured to dispute this opinion.

Not until the twentieth century was the wisdom of rapid alienation of the public domain seriously questioned, and even then there was no abrupt change in policy. Not until the 1930's did it become fashionable to assert that many of the current maladjustments in land use stemmed from past mistakes. Unrestricted settlement no longer appeared to be the right way to get the right farmers to the right lands. Some areas should never have been opened to farming, others should not have been disposed of as homesteads of 160 acres. The stimulus of free land had often led to land-mining, and to it was attributable also some of the blame for the overdevelopment of agricultural production and the unbalance in our national economy.

Let us look briefly at what is probably the clearest instance in which hindsight has disclosed serious mistakes in federal policy. In the area of the great plains the 160-acre homestead was an uneconomical unit and many parts of the area should never have been broken by the plow.[2]

[2] The boundaries of the great-plains area can be differently defined depending upon the criteria, but the customary limits are the Rockies on the west, the one-

For twenty years after the Civil War the great plains supported a prosperous range cattle industry. Assisted in marketing their products by the extension of the railway net, the cattlemen pastured their cattle on the open range, disturbed only by marauding Indians. Gradually the intrusion first of the sheepmen and then of the homesteaders caused trouble, and against this the cattlemen fought both by intimidation of the newcomers and by fencing of the public domain. Neither was successful. The homesteaders were politically powerful and Congress, in response to their appeals, made fencing of the domain unlawful in 1885, and it narrowly limited the amount of free land that anyone could acquire or preëmpt. There was, however, another obstacle to the advance of the homesteaders. After 1885 a succession of dry years, coupled with low prices for grain, brought ruin to many farmers in the great plains. But from this bitter experience no lesson was drawn; and when after 1894 the price of wheat rose, rainfall increased, drought-resistant grains were developed, and the techniques of dry-farming were learned, a new wave of settlement poured into the plains. The federal government after 1902 entered into irrigation schemes. Originally the plan was that the revenue from the sale of public lands in the semiarid states should be used to construct the projects, the settlers making payments sufficient to cover the costs and thus setting up a revolving fund. This plan never worked because costs were regularly higher and payments regularly lower than was estimated. And state irrigation projects, mostly undertaken after World War I, had a fiscal record which was equally unsatisfactory.

Meanwhile the unsuitability of the 160-acre farm had received spasmodic attention from Congress,[3] and in 1904 a public lands commission recommended that the Secretary of Agriculture have the power to withdraw range land from entry. But Congress, in the face of western opposition, was unwilling to go so far. In-

hundredth meridian on the east, and northern Texas on the south. This embraces 359,300,000 acres, containing a population in 1930 of 4,411,624 persons (excluding Denver County, Colorado). See U.S., Great Plains Committee, *The Future of the Great Plains* (Washington, 1936), p. 23, p. 29. The most significant characteristic of the area is its light rainfall, and although the prevalence of drought has suggested that the rainfall is distinctly variable, this appears to be an error. In an area in which the *normal* is so close to the minimum rainfall for successful agriculture, *any* deficiency means drought.

[3] By the timber culture act of 1873, the desert land act of 1877, and the timber and stone act of 1878.

stead, in a fumbling way, it permitted enlarged homesteads (320 acres in 1909) in the arid and semiarid areas, and in 1916 it tried, by the stock-raising homestead act, to make the homesteader a small-scale rancher by authorizing 640-acre homesteads in selected areas. This measure has been sharply criticized.

> The enactment and operation of the 640-acre homestead act was one of the most disastrous blunders in the history of the American land policy. Its framers, recognizing that there was little remaining land suitable for agricultural homesteads, sought to encourage incoming settlers to become small stockmen by permitting them to homestead upon a larger unit of land than was open to entry in the humid areas. . . . But in most parts of the semiarid country 640 acres is entirely inadequate for an economical stock-raising unit—5 to 10 sections being a more suitable unit of operation. Furthermore, the great majority of immigrants seeking homesteads possessed neither the requisite capital nor the experience to enable them to enter the cattle or sheep business. It fell out, therefore, that the hordes of incoming settlers who were drawn to the West by the attraction of 640-acre homesteads in the years from 1917 to the present were forced to become dry farmers on lands which were by no means suitable for such use.[4]

During the 1920's, however, the seeds of trouble did not really sprout. Indeed, a strong group advocated cession of the remaining federal domain to the states in which it was located, and a committee appointed by President Hoover actually recommended this step.[5] The western point of view, that the public lands belonged to the people in public land states and that in state hands these could be developed most rapidly, was approved over the conservationist point of view which demanded withdrawal of land from entry. The recommendation was, however, never implemented because the onset of depression made it clear that many western states were fiscally unable to assume the burden of administering their lands.

The 1930's brought to the great plains not only depression but also serious drought. It came to be realized that there were here "perhaps 24,000 crop farms, covering a total of 15,000,000 acres, which should no longer be plowed"; that the range lands, because of overstocking and drought, had seriously deteriorated; and that here was a problem national in magnitude and in origin. Perhaps 165,000 people moved from the drought area in 1930–1936, and

[4] *Supplementary Report of the Land Planning Committee,* Part VII, p. 73.

[5] *Report of the Committee on the Conservation and Administration of the Public Domain* (Washington, 1931), p. 2. Mineral rights in the ceded lands were to be reserved by the federal government.

the exodus would have been larger but for heavy relief expenditures.[6] Between April 1933 and June 1936, the federal government alone spent $132,700,000 for relief in this area, the amount running in some counties as high as $200 per capita.[7] Drought assistance was, of course, extended to more than half of the United States, and over one-half of the total federal expenditure went to the states in the great plains.

In these sorry years a radical shift took place in the direction of the federal policy toward the public domain. Land acquisition programs were started not only for purposes of conservation and restoration, "but also as a means of assisting in preventing or correcting maladjustments in land use that stand in the way of the fullest and most effective utilization of our national resources."[8] The problem of protecting the public grazing lands was attacked by the Taylor grazing act of 1934 which authorized the withdrawal from homestead entry of virtually all the remaining unreserved public land[9] and their organization into grazing districts. By executive orders entry has been withdrawn and thus, after a period of nearly three-quarters of a century, the right to obtain a homestead has been terminated. Quite apart from the grazing program, free entry was inconsistent with the program for the withdrawal of submarginal lands from cultivation which was authorized by the national industrial recovery act of 1933 and continued by the emergency relief act of 1935 and the Bankhead-Jones farm tenant act of 1937. A total of over 11,000,000 had been purchased by June 1940.[10]

No attempt can be made here to outline all the other steps which have been taken. It is common knowledge that the federal government has assumed new responsibilities for the relief of agricultural distress and for a program of better land utilization.[11] While federal leadership and assumption of the financial

[6] *The Future of the Great Plains*, p. 77.

[7] *Ibid.*, pp. 55–56.

[8] National Resources Planning Board, *Public Land Acquisition in a National Land-use Program* (Washington, 1940), p. 2.

[9] The act in 1934 specified withdrawal of 80 million acres, and amendment in 1936 raised the figure to 142 million. One-half of the grazing fees collected are to be remitted to the state in which the grazing district is located, and of the remainder, one-half is to go for the rehabilitation of the range.

[10] *Public Land Acquisition*, Part I, p. 16.

[11] To 1941 "some thirty-five million acres have been taken out of soil-depleting, erosion-inducing crops and put to close-growing soil-conserving crops. About ten

burden are essential, many intergovernmental problems remain to be solved. The most common difficulty is that federal acquisition removes land from the local tax base, thus disrupting the principal source of local revenue. In numerous acts the federal government has recognized this problem by providing for special payments to the local (or state) governments.[12] But in very many cases these so-called *in lieu* payments are subterfuges which raise more problems than they solve. Should a federal program, designed to rehabilitate a decadent area and provide a sound foundation for local government, be accompanied by this sort of subsidization? Direct federal payments to local governments may often help perpetuate—or at least hinder reorganization of—obsolete local units. Often, therefore, it may be wise to make payments to the state governments, leaving to them the task of appropriate distribution to the localities. Certainly in those states where there has been a serious effort to face issues of reorganization of local governments, the federal programs should be coördinated with the state program.

Forests

THE FOREST RESERVES

For many decades the attitude of the American people toward their forests did not differ from their attitude toward the whole of the public domain. Disposal into private hands so as to promote settlement or to gain a public revenue was accepted with little question. When in 1876 Carl Schurz as Secretary of the Interior advocated retention, rather than disposal, of the forests, this seemed esoteric and foreign. And indeed the plan was esoteric

million acres have been custom-cultivated. Half a million gullies have been stabilized. About 1,800,000 miles of terraces have been constructed. Two million acres have been strip-cropped. And all over America, millions of trees have been planted. Incomes have been improved, eleven million acres of submarginal land have been retired from agriculture, the grazing lands of the West have been brought under partial control, many destitute farm families have taken a firmer grip on themselves and their resources." Milton S. Eisenhower, "Federal Responsibilities in Total Conservation," in *Conservation of Renewable National Resources* (University of Pennsylvania Bicentennial Conference, Philadelphia, 1941), p. 185.

12 The Taylor grazing act provides for remission of one-half of the fees; 25 per cent of the gross receipts from national forest reservations are turned over to the states; 37½ per cent of the gross proceeds of royalties and rentals from mineral leases granted on public lands are paid to the states. The list could be greatly extended. For a brief summary see *Public Land Acquisition*, p. 9.

because it presumed expert and honest administration, and long-run planning by the federal government. But the conservation movement did gain strength and fifteen years later, in 1891, the president was given the power to create forest reserves. Under this legislation and later amendments 135,000,000 acres have been set aside. This was not done without opposition, particularly from the states in which the reserves were located. They insisted that withdrawal of areas from settlement and exploitation interfered with their economic development. Why should the East, after it had exhausted its own forests, bottle up the natural resources of the younger states? It was the belief of Representative Martin of Colorado that "the less public domain and the less natural resources a member of Congress has in his state, the more enthusiastic he is about conservation." [13] And the western states were only moderately placated by legislation which provided in 1908 that 25 per cent (10 per cent in 1906) of the revenues from the national forests should be paid to the states in which the reserves were located for the benefit of public schools and roads.

The policy of setting aside certain portions of the public domain did not, of course, meet the problem of forest conservation in those regions in which there were no federal lands. A few states, particularly in the northeast, soon developed sound forestry policies of their own; but most lacked the fiscal resources, the incentive, and even the constitutional power to move. In 1911 the federal government intervened by passage of the Weeks act which, among other things,[14] provided appropriations for the purchase of land in watersheds of navigable streams in the Appalachian and White mountains. One principal ground of opposition to the measure was constitutional. Ostensibly for the purpose of protecting watersheds, in reality the aim was forest conservation. But Congressmen in New England and the South were willing to throw over the doctrine of states' rights for the sake of legislation which they desired, although it should be noticed that state consent to federal purchase had to be given before action could be taken in any state. The limitations of the Weeks act with respect to area were later lifted, and by the Clarke–McNary act of 1924 so also was the limitation which confined purchases to watersheds. Additional appropriations have been provided, especially

[13] John Ise, *The United States Forest Policy* (New Haven, 1920), p. 272.
[14] Notably a forest-fire prevention program.

in 1933–34, and thus the federal government has added to its forest domain in the older eastern states. Altogether nearly 17,000,000 acres have been acquired by purchase.[15]

Expression of the results of this program in terms of acreage does not indicate their full significance. Large areas in private hands had been stripped of valuable timber and then abandoned. Restoration of such areas is seldom an attractive field for private capital because of the long time required for forest growth, and the system of property taxation which is based upon capital value has been an added handicap. One might, perhaps, expect from the eloquent and alarming preachments of the conservationists about our vanishing forests that timber would grow in value and attract private investment. But it is an ironical fact that at the very time—the 1900's—when the conservationists caught the public ear, our consumption of timber began to decline, and this trend has continued nearly to the present. From a per capita consumption of 505 board feet in 1904, the figure had fallen to 345 in 1924 and to 130 in 1931. The strength of the conservationist argument rests not upon any prospective shortage of forest products, but upon the influence of forests upon stream flow, soil protection, and climate. In the middle 1920's it did seem for a time that timber prices had improved. After 1926, however, they declined and with depression tax delinquency of forest lands developed on an enormous scale. In the three Lake states in 1933 some 18 to 20 million acres were delinquent—35 per cent of the forest area of these states; in the South 20 million acres were chronically delinquent. In real truth it was proper to speak of a breakdown of private ownership, and the idea that the government should reacquire a large portion of the forest lands of the nation gained a new significance.

[15] *Public Land Acquisition,* p. 14. In 1940 the national forests in the United States include 135,000,000 acres reserved from the public domain, 17,000,000 acres purchased, 2,000,000 obtained by donation, exchange, etc.—a total of 154,000,000 acres. In addition there are 21,000,000 acres of national forests in Alaska. The national forests are about 28 per cent of total forests in the United States.

The Fulmer act of 1935 authorized federal purchase of forest land and sale to the state for the purpose of establishing state forests, the state paying the federal government out of income and managing the forests according to agreed rules. Expansion of the federal funds for the purpose was recommended by the Joint Congressional Committee on Forests (U.S., 77th Congress, 1st session, Senate Document No. 32: *Forest Lands of the U.S.*).

GRANTS FOR FIRE PROTECTION

The federal government has, for many years, recognized that it has another responsibility in forest policy. The Weeks act in 1911, besides providing for federal acquisition of forest lands, also made provision for federal coöperation with the states in fire protection for the watersheds of navigable streams. Grants in aid of specified activities were begun, and these have grown in amount from $36,700 in 1911 to $2,074,000 in 1940.[16] In 1940 forty-one states were participating and 281,000,000 acres of forest land were being given fire protection.

There can be no doubt that the states have been stimulated by the program. Before 1911 only sixteen states appropriated any money for forest-fire protection and it was commonly felt that the private owner should bear the expense of fire protection to private lands. The Weeks act endorsed the view that at least part of this cost should be public. It is a fact that forest fires are caused most frequently by persons other than the owner and that prevention calls for exercise of the police power. Moreover, forest fires wherever or however started do not respect any boundaries, and therefore public expenditure to protect private forests serves also to protect public forests, federal or state. Federal stimulus was essential to encourage the laggard states and to improve state standards.

In the northeast, acceptance of forest-fire protection as a public function has gone far; in the west, the tendency has been to put much of the cost upon the private owner, and this has been fairly successful because the private holdings have been valuable and currently productive. In the south, fire protection is less adequate than in any other section. In 1931 the Copeland committee found that only 24 per cent of the forest area there was protected.[17] These state governments have been little interested in placing a larger burden upon private owners or in accepting a heavier expenditure of their own. There have been suggestions

[16] In 1940 about $9,027,000 was spent for forest-fire protection of which 52 per cent was provided by the states, 23 per cent by the federal government, and 25 per cent by private owners. *Report of the Chief of the Forest Service*, 1941 (Washington, 1942), p. 23.

[17] 48,183,000 out of 202,904,000 acres. U.S., 73rd Congress, 1st session, Senate Document No. 12: *A National Plan for American Forestry* (Washington, 1933), p. 1058.

that more generous federal aid, coupled with conditions which forced improvement in state personnel and organization, would provide a remedy.[18] The Joint Congressional Committee on Forestry in 1941 recommended that the Clarke–McNary grants be increased by steps to $10,000,000 annually.

Doubtless something could be accomplished, but the vast differences in the attitude of the states toward forest regulation must be recognized. In those where forests are abundant, the pioneer opinion, which regards forests as an inexhaustible resource or as an encumbrance to arable land, stands in the way of regulations which seem almost inevitable in an older state. Again, the actual need for regulation against, e.g., fire hazards, is not the same from region to region: the pine forests of the south are not damaged nearly so badly by fire as are the hardwood forests of the central states, and the production of naval stores in the south requires the use of fire. The Committee gave indirect recognition of these facts by favoring establishment of stricter federal conditions to the end that the states may be compelled, through threat of withdrawal of the grant, to see that a proper system of fire protection is established. The United States Forest Service would go farther. If a state did not set up a proper regulatory system, the Service desires authority to provide direct federal regulation of privately owned forests. The practical possibilities of this program are greatly inferior to those of the Congressional Committee.

REACQUISITION OF FOREST DOMAIN

At present few would dispute the assertion that private ownership of forests has many defects. Four-fifths of our commercial forest lands are in private hands and adequate expenditure for reforestation, for protection, and for research has been lacking. Most of the expenditure for these purposes has been public and it has necessarily been concentrated upon a small portion of the total forests. An adequate remedial forest program therefore requires not merely better public regulation of privately owned forests, but also extension of public ownership.

[18] National Resources Committee, *Supplementary Report of the Land Planning Committee,* Part VIII: "Forest Land Resources, Requirements, Problems, and Policy," p. 93. The Copeland Report recommended federal grants of $3,700,000 a year. Minor federal aids to forestry, such as grants to help finance state distribution of forest planting stock to farmers and for farm-woodland management, cannot be treated here.

In 1933 the federal Forest Service, by the report of the Copeland committee, plumped for a vast program of this sort. Of the 500,000,000 acres of commercial forest lands, it declared that public holdings should be increased from 100,000,000 to 293,000,000 acres. There are, besides, 110,000,000 acres of noncommercial forest lands, of which less than 30,000,000 acres are in public hands. The recommendation about them was that the public holdings be increased to 92,000,000 acres. Obviously this would require a large expenditure—the estimate is $750,000,000 of which the federal government would carry $500,000,000 spread over a twenty-year period.

No detailed discussion of this grandiose scheme will be attempted. Apart from the considerable fiscal problem, public purchase must be a tedious and complicated process. Care would have to be taken not to dislocate the tax basis of local governments or the economic activities of individuals who were owners or who were dependent upon industries which used the forests. Large-scale purchase is likely also to be expensive and litigious. Yet it must be conceded that the basic principle upon which the recommendations were founded is sound. Land capable of growing forests and for which no more significant use can be foreseen, should be so used—i.e., cut-over and abandoned areas or areas depleted by fire, land submarginal for agriculture, segments of privately-owned forest land in public forests, areas which should be in public hands in order to serve as soil protection, etc. In these instances private ownership does not appear to function. And it should be stressed that a program of acquisition requires federal–state coöperation.[19] Every aspect will probably require *financial* assistance from the federal government, although it would be wise to insist upon substantial state participation wherever state interests are at stake. Only when, as in the case of watershed protection and erosion control, the national interest is predominant, should the federal government assume all the cost.

It seems desirable, therefore, that acquisition of a new public domain by purchase should go on, and in addition there will be some accretion through tax delinquency. The spectacle of purchase by government of denuded lands, which at an earlier date it had sold or given away, is somewhat incongruous, but to act

[19] *Supplementary Report of the Land Planning Committee*, Part VII, p. 54.

otherwise would be to refuse to rectify demonstrable errors. And federal aid to the states to assist in fire protection and forestry research should be extended. Survey of the problem in its entirety will, however, lead to the very inconclusive conclusion that no simple public policy for American forestry can be laid down because different regions have different problems. The vanishing forests theory, which has so intrigued the northeast, has little appeal to the south or west.

And however unwise alienation of forest lands now seems to have been, it must be remembered that until the twentieth century the idea of encouraging settlement dominated the thought of the American people. As one student has said:

> The Americans have been a wasteful and extravagant people in their use of all natural resources, but there are circumstances under which this wastefulness was not only inevitable, but even wise. The people of America could not possibly have treated their forests with the same care that Europeans have shown, for there were too many forests and too few people.[20]

Conservation of any natural resource is a relative concept. If, finally, one is to persist in condemning federal and state governments for alienation of the domain, one should also reflect that these same governments might also have done badly in holding the land in trust. The federal government of the United States and the governments of many states were not always fit trustees for conservation of a natural resource.

Oil

FEDERAL ATTITUDE TO 1933

"If," says John Ise, "all of the United States had been fit for cultivation, probably all of the land, even in the western states, would have been taken up by settlers, under laws which gave the surface owner title to all the mineral deposits; and the federal government would never have owned any oil lands." [21] At present the quantity of oil produced in federal lands is small—less than 2 per cent of the total; and although a larger amount is produced on state lands the great percentage comes from lands that have passed into private ownership. In short, alienation of this

[20] Ise, *The United States Forest Policy* (New Haven, second printing, 1924), p. 374.

[21] John Ise, *The United States Oil Policy* (New Haven, 1925), p. 291.

natural resource has gone so far that what is done by way of conservation must proceed by public regulation rather than by management of a resource still in the public possession.

In 1906 President Roosevelt, thinking primarily of coal, stated that "the time has come when no oil or coal lands owned by the government, either upon the public domain or in territory owned by the Indian tribes, should be alienated. The fee to such lands should be kept in the United States Government. . . ." [22] His action in withdrawing coal lands from entry, and the action of President Taft in 1909 in withdrawing oil lands, were sharply attacked by many Congressmen from the western states.[23] When after 1915 a decline in the production of oil coincided with a rapid growth in consumption and the rise of imperative war needs, interest in conservation grew. But not until 1920 was a leasing act passed and this new measure was declared by critics to be "a complete reversal of the original land policy of the United States. . . . The rights of the West, and particularly states rights, have been jeopardized by the enthusiastic federal control school which seemed to have taken the lead in proclaiming federal over state rights." [24] The west still held that the only proper federal policy was rapid exploitation of the public domain now as in the past.[25]

Soon afterwards the nation was shocked by one of the grossest episodes in American public life, centering around the Secretary of the Interior, Albert Fall of New Mexico, who had always been

[22] Message to Congress, May 1906. Quoted by Ise, *Oil Policy*, p. 309.

[23] Ise, p. 317, quotes the condemnation which Senator Heyburn made of the whole conservation movement: "Are you going to make life a downy bed of ease for the children of the future, with no problems for them to solve, with no tests of their strength and ingenuity to put them on their mettle? Are you going to soften and degenerate all our descendants in the days that are to come by saving up for them all the good things, while their fathers and their mothers hunger in vain for what is so bountifully about us? My doctrine upon that subject, Mr. President, is that future generations, like the past and the present, must and should grapple with the problems of their day. . . ."

[24] *Colorado School of Mines Magazine*, March 20, 1920, p. 48, quoted by Ise, p. 352.

[25] By a curious quirk of history federal policy toward the Indians has become entangled with federal oil policy. In order to keep certain Indian tribes away from contact with the white people, they were placed on territory in Oklahoma containing lands, as it was supposed, of little value. It turned out that this territory contained some of the richest oil lands in the United States, and when the Indians were suddenly enriched, the federal government had the difficult job of protecting its wards against despoilment. It could not, however, prevent demoralization of Indians who were suddenly made affluent, and it has been criticized also for permitting too rapid exploitation of the Indian lands. See Ise, p. 399.

an opponent of conservation and an advocate of "development." The Navy Department, beginning in 1912, had secured creation of petroleum reserves in certain areas which were set aside from lease and entry, the most important being the Teapot Dome reserve in Wyoming. In the spring of 1922 it was disclosed in suspicious circumstances that this reserve had been leased without competitive bidding, and a long inquiry proved that it and several other reserves had been looted. Two of the biggest oil men in the country, H. F. Sinclair and E. L. Doheny, had bribed Secretary Fall, and suspicion was thrown also upon a wide circle of prominent politicians. Federal officers, through corrupt administration, had been bad trustees of the public domain.

Meanwhile in 1924 President Coolidge established the Federal Oil Conservation Board to examine the question of the adequacy of the oil resources of the United States. For the first time the public became aware of the wide range of opinions concerning the prospects of the industry. Some declared that a shortage of production impended, while others insisted that there was no limit to discoveries; some urged federal regulation both to conserve a natural resource and to stabilize an erratic industry, while others decried any such steps. The Board itself decided that, whatever might be wrong, the industry itself would find a remedy; a forecast which was called in doubt when, in the next few years, new discoveries brought flush wells into production and the price of oil fell rapidly. Some of the states turned to compulsory proration of production, but for reasons which will appear later this was ineffective. In 1929 the Board seemed sympathetic to a proposal of the American Petroleum Institute that the industry be released from operation of the antitrust laws, but the Attorney General declared this to be a matter for the decision of Congress and not of the Board.

At this stage the suggestion of an interstate compact to limit production gained new importance; and when in 1930–31 the vast East Texas oil field was discovered and put into production, with a consequent drop in the price of oil, the need for some remedial action seemed imperative.[26] In September 1931, Kansas, Oklahoma, and Texas entered into an informal production compact setting quotas for each state. But soon there were difficulties in

[26] "The price of 38° midcontinent crude had fallen from $1.01 on January 1, 1931 to $0.20 by July 8, 1931." Northcutt Ely, *Oil Conservation through Interstate Agreement* (Fuel Conservation Board, Washington, 1933), p. 263.

enforcing the agreement within the states. The governors of Texas and Oklahoma declared martial law and sent troops to the oil fields to close wells. The courts, however, repeatedly struck down this sort of action [27] and they were, besides, hostile to proration orders. Low-cost producers in the new flush fields objected to quotas limiting their production, especially when they saw competitors in the other states—Montana, Michigan, California—not within the agreement and not subject to restrictions. Methods of evasion were so numerous and so successful that the whole country soon became aware of the flow of "hot" oil.

By 1933 most people were ready for federal intervention, and by section 9 (c) of the national industrial recovery act the first special federal legislation about the oil industry was passed. This section empowered the President to prohibit interstate transportation of "hot" oil, i.e., oil produced or withdrawn from storage in excess of amounts allowed by state legislation. But in 1935 [28] the Supreme Court struck down section 9 (c), and later in the same year it invalidated the whole NIRA, thereby destroying the code which had been set up for the petroleum industry. The industry, finding its problems cast back upon it, turned again to the interstate compact, this time to be legally authorized by the federal government.

INSTABILITY OF THE INDUSTRY

Before describing the system of regulation which has developed, it will be well to notice certain technical peculiarities of the industry which have some responsibility for its recurrent difficulties.

Predictions of a prospective exhaustion of the oil supply of the United States began over half a century ago and most of the early guesses were erroneous or misleading. Geophysical science can estimate with fair accuracy the oil contained in producing fields, i.e., the proven reserves; and at present when an estimate is made of the nation's reserves of recoverable oil, this is what is meant. These estimates are themselves subject to revision as improved methods of recovery are invented. Thus in the past twelve years the depth which can be reached by commercial drilling has dou-

[27] Notably by *Constantin* v. *Smith,* 287 U.S. 378.
[28] *Panama Refining Co.* v. *Ryan,* 293 U.S. 388.

bled,[29] and the recovery of the oil from the reservoir sands has been vastly improved. A more incalculable factor is new discovery of oil fields. Here geological knowledge is important in directing exploration, but "wildcatting" still brings results and the volume of future oil production is affected by this unpredictable factor.

While early pessimistic forecasts about our oil reserves have been erroneous, there was reason to be alarmed at the wasteful methods used in the production of an exhaustible and valuable resource. The significance of natural gas as an agent for the recovery of oil was not at first appreciated. "Gushers" were common both because of an inadequate technique in capping wells and because drillers did not take proper precautions. Besides waste through leaving too much oil in the ground and in bringing wells under control, there has been waste in the storage, transportation, and refining of oil. In the early days oil was often run into earthen sumps because no other storage was available, and this brought waste through evaporation and deterioration. Such faults have been corrected and in recent years "a great improvement has occurred in methods and equipment for handling crude petroleum from the well to the refinery." [30] The wastes which result from the wide swings in discovery and production are, however, still serious. When new and rich areas are opened, production accelerates rapidly and prices drop sharply, with demoralization of the whole industry.

The natural factors making for instability have been supported by an anomalous legal technicality, the rule of capture, which ascribes ownership not to the oil in place, but to the oil when reduced to possession. This rule, taken over from the common law, originated at a time when almost nothing was known of the conditions under which oil occurs. The notion was that

> an oil well produced oil, as a spring produced water, and was itself, consequently, the subject of a property right. But from an engineering standpoint, it has been said that the well is nothing but a vertical pipeline which permits the reservoir, as an engine, to transport oil to the surface of the

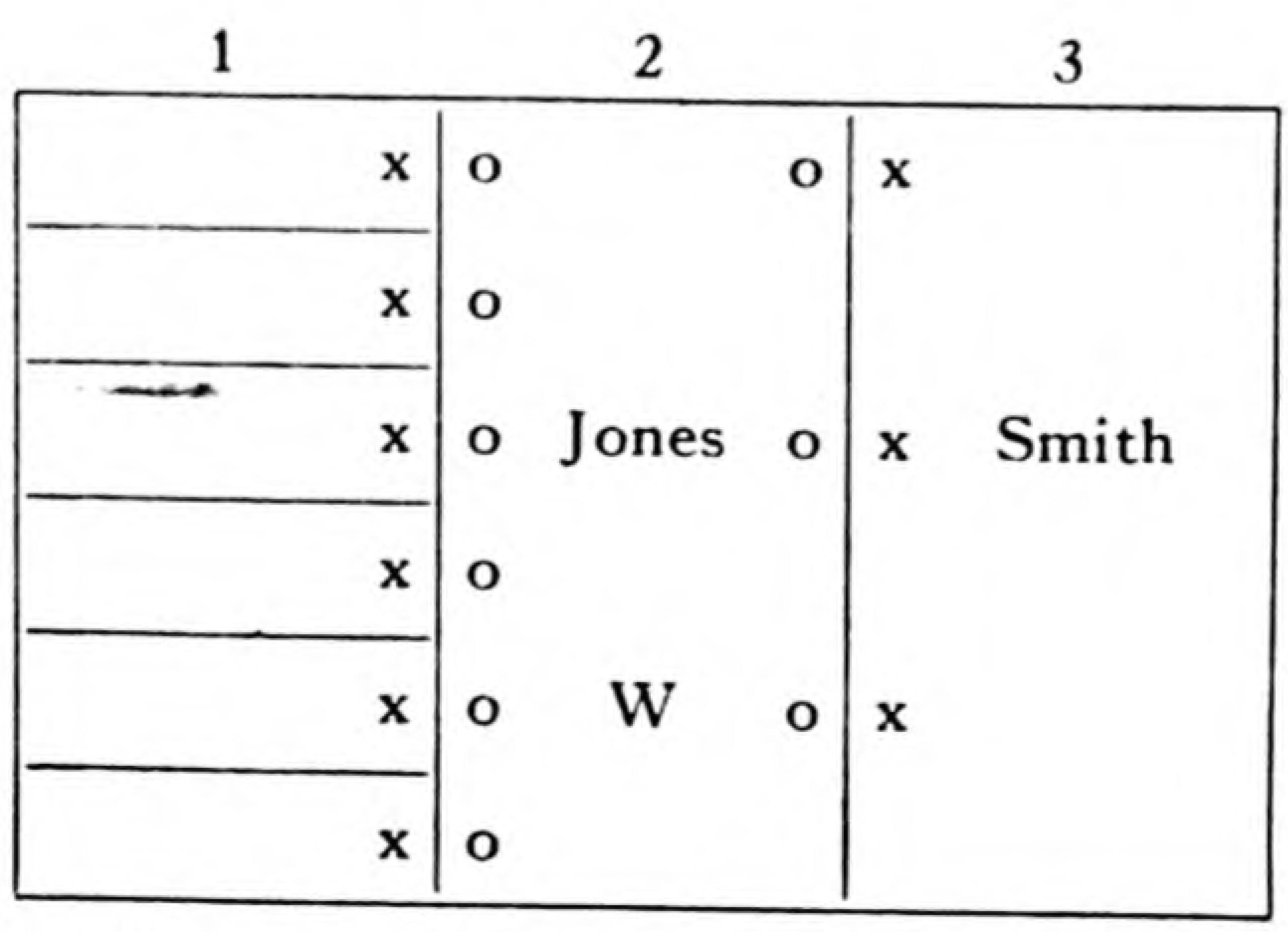
[29] J. E. Pogue, *Economics of the Petroleum Industry* (New York, 1939), p. 28. "It has been estimated that operating practices until about 1925 led generally to the recovery of only 10 to 20 percent of the original oil from the reservoir sands" (*Energy Resources and National Policy*, Report of the Energy Resources Committee to the National Resources Committee, Washington, 1939, p. 21). At present 30–60 per cent can be obtained "by primary methods of recovery."

[30] *Energy Resources*, p. 187.

lease. . . . Under ideal conditions, these natural underground forces, i.e., water-drive, gas pressure, and so on, may be harnessed and controlled as to lift to the surface 90 to 95 percent of the oil which is contained in the reservoir, by flowing, over a long period of years. But when oil is produced without restriction, the engine figuratively races itself to pieces: the gas, which has accumulated on top of the oil, is blown off; the underlying water rushes up through the oil-bearing sand to the well, and traps off oil; and the gas dissolved in the oil is permitted to escape so rapidly that the remaining oil is left too thick and viscous to be propelled through the rock by the diminishing pressure. The well has then to be pumped, producing much smaller quantities at a much higher cost.[31]

In the United States the divided oil pool is the usual thing. Most of the lands under which oil is found have passed into private ownership, and the prospector, drilling for oil, obtains from the owner a lease to do so. If oil is discovered, the return to the leaser is usually in the form of a royalty on the production and therefore he, as well as the leasee, is interested in getting as much oil out of the ground as possible and in seeing that his share is not curtailed by drainage elsewhere. Even when the land is public, the divided pool is usual because the federal government and the states, inspired by the idea of maintaining competition and securing rapid development, have given leases for small areas. Moreover, oil operators, in order to share the heavy costs of discovery and the riches of prosperity, have frequently agreed that, when a pool is found, it is to be divided. The divided oil pool, together with the rule of capture, gives an incentive to each operator to drill as many wells as he can and to withdraw the oil as rapidly as possible.

An example, given by Representative Pettengill, will make this clear.



[31] Northcutt Ely, "The Conservation of Oil," *Harvard Law Review,* May 1938, pp. 1219–20.

> Here we have three tracts of land. Number 1 has been subdivided into town lots and the lots sold to six different owners. Jones discovers oil in the centre of tract "W." Smith immediately drills a well on his tract as close to the boundary and as near to the proven well "W" as he can. We mark it "X." "X" will drain oil from beneath Jones' land, so Jones drills an offset "O" opposite "X." Smith drills other wells along the line and Jones drills other offsets. Meanwhile the town lot owners get the fever and each of them drills wells and Jones drills offsets opposite each of them. Soon there are 19 or 90 wells drilled when three, let us say, would have been not only all that were necessary, but all that were desirable from the standpoint of getting out of the underground pool the largest percent possible of its contents.[32]

And no elaboration is necessary to realize that stimulus to rapid production of a commodity which cannot easily be stored, upsets the market and may force premature abandonment of older wells.

THE INTERSTATE COMPACT

It should be clear that the power of a single state to remedy the ills of the industry is limited, since any attempt to limit production may force its operators to lose markets to competitors in other states. This realization lay behind early advocacy of the interstate compact, and when in 1935 section 9 (a) of the NIRA was struck down by the Supreme Court, New Mexico, Kansas, Oklahoma, Illinois, Colorado, and Texas executed a compact with the approval of the federal government. By it these states agreed to meet periodically and settle upon production quotas, and the factual basis for discussion has been estimates of the demand for petroleum made by the federal Bureau of Mines.[33] Louisiana, Wyoming, Arkansas, and Michigan, which were not at first in the compact, also generally adhered to the figures set by the Bureau. It is the job of each individual state to prorate its quota, and this requires determination of the proper "allowable" production for each pool per time period and apportionment of this among the different operators. From the point of view of conservation the aim ought to be to restrict the flow of oil to its optimum rate, so that the best utilization of reservoir pressure will be secured, and to divide the oil recovered fairly between the properties.[34] In this

[32] S. B. Pettengill, *Hot Oil* (New York, 1936), pp. 73–74.

[33] See *Energy Resources*, p. 403, for the method used by the Bureau in its estimates.

[34] M. W. Watkins, *Oil: Stabilization or Conservation* (New York, 1937), pp. 50–51.

each state has jealously insisted on its own sovereignty and has warded off any interference either from the members of the compact or the federal government.

The federal government has, however, participated in the state program of regulation through the Connally act, passed in 1935 (and extended since). This act prohibits interstate and foreign commerce in hot oil. Congress, in effect, allows the oil states to determine the amount of oil which is to pass in interstate commerce and backs up these state decisions. It is not hard to find fault with this procedure. Why should the half dozen states which produce most of our oil make decisions which seem to be of national importance, since the large consuming markets are outside the producing states? If production restriction is desirable in the interests of conservation or of stabilization of the industry, should not safeguards be provided so that neither particular states nor individuals gain at the expense of the nation? The present scheme is, besides, on a precarious basis in that it can be broken by state jealousies. Certain oil states are not in the compact at all; those which are in may feel that they are making sacrifices in support of proration, and may therefore get out.

Some people have urged the desirability—even the necessity—of federal intervention to determine the amount of production and the commerce in petroleum.[35] The states might be allowed to distribute the allowed amount among the individual producers, subject to specific standards of operation set by the federal authorities. In the past there has been doubt about the constitutionality of such federal controls. In 1926, Mr. Hughes, before he became chief justice and in the capacity of counsel for the American Petroleum Institute, argued that "production is not commerce and the production of petroleum within a state is not interstate commerce"; [36] and he went on to say: "It may therefore be safely taken for granted that, under the power to regulate commerce, Congress has no constitutional authority to control the mere production of petroleum on lands (other than Indian lands) within

[35] *Energy Resources*, p. 227. It should be noticed that the federal government since 1932 has imposed an excise tax on imports of gasoline (2½ cents a gallon) and crude oil (21 cents a barrel). Imports, except during the years 1919–1923, have never been important, and the significance and purpose of the excises have never been very clear.

[36] Quoted by Pettengill, *Hot Oil*, p. 224.

the territory of a state." Constitutional opinions, however, have not remained static since 1926, and the assertion has been made that the decisions of the Supreme Court in the National Labor Relations Board cases have overshadowed its earlier views. These decisions indicate that industries, organized on a national scale and predominantly interstate in character, may be regulated by the federal government under the interstate commerce clause. It may be also that the defense powers and the taxing powers will enable the federal government to regulate production and distribution of oil and gas. The National Resources Board has, accordingly, proposed that a Federal Oil and Gas Conservation Body be created

> to administer the Federal interest in the gas and oil industry and to make necessary rules and regulations concerning the production, treating and refining of oil and gas, and that the Connally act be strengthened to prohibit interstate commerce of oil and gas produced in violation of federal as well as state laws.[37]

The failure of the federal government so far to participate very significantly in oil regulation rests, of course, upon more than a doubtful constitutional authority. The public—and therefore Congress—has not been interested because in the past new discoveries, coupled with technological progress, have pushed down the price of gasoline even in the face of growing consumption and heavier taxation. How long this unusual set of circumstances will continue can hardly be forecast and war demands may give the impetus toward greater federal control. The industry itself is, of course, certain to object to this sort of move. Of greater political consequence will be the objections of the oil-producing states. They are fearful of every move which might diminish their power over resources from which they gain so much income both directly and indirectly, and their opposition is likely to prevent drastic federal action.[38] It is, nevertheless, anomalous that

[37] *Energy Resources*, pp. 231–233.

[38] The oil-providing states bitterly opposed bills making for a larger federal control. (See U.S., 76th Congress, 3rd session, House Hearings, Committee on Interstate and Foreign Commerce on H.R. 7372, Petroleum Investigation.) For example (p. 977), Governor Phillips of Oklahoma declared: "There is no necessity for the Federal Government to undertake to enact legislation to prevent physical waste in the production of oil when the States are already efficiently doing this." This sort of legislation was damned as unconstitutional and undemocratic. Secretary Ickes (pp. 515–44) argued for the legislation.

an industry "which delivers energy by exhaustion of a natural resource" should be regulated almost entirely by the laws of a few states, while another industry—the power business—"which delivers energy largely from falling water and from comparatively limitless supplies of coal, is the target of all the regulatory devices which political ingenuity can supply." [39]

[39] Northcutt Ely, "The Conservation of Oil," *Harvard Law Review*, May 1938, pp. 1241–42.

CHAPTER XIII

TAXATION OF INCOME

Taxation of Personal Income

If the commerce and industry and population movements of this country have taken on a complex Nation-wide character, the safeguarding and promotion of this development becomes a national responsibility. If the economic system is beset by multiple tax burdens, compliance and administrative costs, and by upsetting differentials, it is the duty of the Federal Government to remove these obstacles to economic activity and progress. It is not an impairment of State rights to create conditions under which the States will find it advantageous to coöperate and to enact and enforce desirable measures, which in the absence of such conditions do not appeal to the self-interest of the individual States.[1]

Until the passage of the Wisconsin law in 1911, the half-hearted efforts of the states to tax income had met with no success. Administration of the early laws was weak, constitutional impediments were numerous, and the states had no fiscal need serious enough to drive them toward a difficult experiment. The success of Wisconsin showed the way; the campaign for the sixteenth amendment, followed by enactment of the federal income tax, familiarized citizens with income taxation. Moreover, existing sources of state revenue, particularly the property tax, displayed signs of weakness and this rallied to the cause many people who had been unmoved by the claim that income taxation was the modern answer to equity in tax burdens.

In the first surge forward, 1911 to 1921, thirteen states began to tax personal incomes,[2] and it was widely expected that before long most states would follow. But from 1921 to 1928 only one state, New Hampshire, passed an income tax law. The states were finding new sources of revenue through taxation of gasoline and motor vehicles; the country was in a conservative temper,

[1] 78th Congress, 1st session, Senate Document No. 69: *Federal, State and Local Government Fiscal Relations,* p. 449.

[2] These thirteen also taxed corporate incomes, and two more taxed only corporate incomes.

and therefore the drive to remove the prohibitions in many state constitutions against taxation of income lost its force.

After 1928, however, a new wave of income taxes swept across the nation. By 1935 thirty-two and by 1941 thirty-five states taxed personal income,[3] with the increase in yield shown in

TABLE 25

REVENUE FROM STATE TAXATION OF PERSONAL INCOME[a]

Year	Millions of dollars
1929	74.6
1935	100.0
1939	198.9
1940	207.8
1941	230.8

[a] *Federal, State and Local Government Fiscal Relations*, p. 432.

Table 25. The increase was appreciable, yet in 1939 the collections were only 5 per cent of total state tax collections. Moreover, three states—New York, California, and Massachusetts—accounted for nearly 70 per cent of the total.

DIVERSITY IN YIELD

Perhaps the diversity in the use and the effectiveness of state taxation of personal income is brought out best by looking at per capita collections. Table 26 shows a very great spread from Arkansas, which secures only $.18 per capita, to New York which secures $6.68. Sixteen states secure less than $1.40 per capita, and only six over $2.00 per capita.

The reasons for this diversity in yields from personal income taxation are numerous and it is impossible to assess the importance of each. The states are not equally rich and they do not, in any case, have similar rate structures or exemptions.[4] A few do not have progressive rates, while others do in different degrees. So

[3] So also did the District of Columbia. Three states—New Hampshire, Ohio, and Tennessee—taxed only the income from intangibles.

[4] See Roy G. Blakey and Violet Johnson, "State Income Taxation," *Taxes*, March–June 1941, p. 256. The common personal exemption for a single person is $1000, since twenty states give it. For heads of families, eleven states give an exemption of $2500, nine give one of $2000. For dependents, ten states allow $400, but the variation below this is considerable, with seven states allowing $300 and nine $200.

TABLE 26

STATE PERSONAL INCOME TAX COLLECTIONS PER CAPITA, 1939[a]

Arkansas	$.18	North Carolina	$ .79
Maryland	.32	Virginia	.82
Tennessee	.36	Idaho	1.00
Alabama	.38	Louisiana	1.00
Mississippi	.39	Oklahoma	1.05
North Dakota	.42	Utah	1.25
New Mexico	.52	Wisconsin	1.29
South Carolina	.63	Iowa	1.38
Kentucky	.69	Massachusetts	2.07
West Virginia	.70	Minnesota	2.93
Kansas	.73	California	3.06
Georgia	.74	Oregon	3.11
Arizona	.76	Delaware	4.15
Montana	.78	New York	6.68

[a] For some states the collections from the personal income tax are not reported separately and are, therefore, not calculated here.

long as the federal tax has highly progressive rates, the possibilities of progression in the state taxes are limited. Even before the depression the states held back because of the fear that large and mobile incomes might move. In 1941 the rates ran to a maximum of 15 per cent in two states,

attained at taxable incomes of $15,000 in North Dakota and $25,000 in California. Twenty-six of the states, including New York and Massachusetts, go no higher than 7 per cent; of these, in turn, eight do not reach a maximum rate of 5 per cent. While the maximum rates are generally low, in consideration of the high federal rates, graduation is fairly steep, although confined to a narrow range of income brackets. Only in California, New Mexico, and South Dakota does graduation proceed beyond the $25,000 level. In fact, about half the states terminate graduation below $10,000.[5]

Examples of the inequality in the amounts of state personal income tax paid by individuals similarly circumstanced are provided in Tables 27 and 28.[6]

These tables speak for themselves. In 1939–40 a married man with two dependents and a net income of $3000 before deducting his federal income tax would pay no tax in nine of the thirty-three states which collected a personal income tax. In four states

[5] *Federal, State and Local Fiscal Relations*, p. 425.

[6] Blakey and Johnson, pp. 232–33. The assumptions made are not reproduced here. For other examples of variation in state personal income taxes see *Studies in Current Tax Problems*, prepared by the Twentieth Century Fund (New York, 1937), pp. 53–96.

TABLE 27

EFFECTIVE STATE TAX FOR HEAD OF FAMILY CONSISTING OF HUSBAND, WIFE, AND TWO DEPENDENTS, 1939–1940

Amount of Income before Deducting Federal Income Tax at 1939 Rates: $3000		$5000		$10,000		$100,000	
Effective tax	Number of states	Effective tax	Number of states	Effective tax	Number of states	Effective tax	Number of states
Under $1	9	0– 49	19	0– 99	4	0–1999	3
1– 9	8	50– 99	11	100–199	11	2000–3999	15
10–19	12	100–199	3	200–299	8	4000–5999	6
20–29	2		—	300–399	6	6000–7999	8
30–39	2		33	400–499	3	8000–9999	1
	—			500–599	0		—
	33			600–699	0		33
				700–799	1		
					—		
					33		

TABLE 28

EFFECTIVE STATE TAX FOR SINGLE PERSON, 1939–1940

Amount of Income before Deducting Federal Income Tax at 1939 Rates: $3000		$5000		$10,000		$100,000	
Effective tax	Number of states	Effective tax	Number of states	Effective tax	Number of states	Effective tax	Number of states
$ 0–19	6	0– 49	6	0– 99	2	0–1999	3
20–39	15	50– 99	14	100–199	6	2000–3999	15
40–59	7	100–149	10	200–299	10	4000–5999	6
60–79	5	150–199	3	300–399	6	6000–7999	8
	—		—	400–499	7	8000–9999	1
	33		33	500–599	2		—
					—		33
					33		

(Minnesota, Oregon, South Dakota, and Iowa) he would pay $20 to $39. A married man in similar conditions, but with an income of $10,000, would pay state income taxes of $67 to $100 in four states, and sums of $400 to $750 in four states.[7]

The point of these illustrations is that, neglecting the possibility of discriminatory taxation in the technical sense, citizens with

[7] The payments would be as follows:

New Mexico	$67.29	Wisconsin	$414.99
California	84.00	Minnesota	420.32
New Hampshire	92.32	Idaho	443.00
Arkansas	99.87	Oregon	740.87

equal incomes in states which tax personal income paid very different amounts in personal income taxation. And it should be remembered that thirteen states were not using the personal income tax at all. One may assert that the people of a state have the right to choose their taxes, and if they prefer to dispense with what is, in the opinion of most theorists, the most equitable type of tax, there should be no complaint from outsiders. Such an assertion forgets that the people of a state are also the people of a nation, and that the tax system of a state may be shaped in a spirit of unfair competition toward its neighbors.

TAX CONFLICTS

So far nothing has been said about the more technical aspects of conflicting taxation, but everyone is aware that states using the personal income tax do not define taxable income in the same way, and that many other important differences exist which make for multiple taxation, and undue costs of administration and of compliance.

Let us notice briefly significant differences in the bases. Wisconsin, the state which pioneered in this field, applied its tax to all income arising in the state, whether received by residents or nonresidents, and five other states, broadly speaking, have followed this practice. Delaware, however, has applied its tax to all income received by residents, in this being followed at present by three other states. If all the states followed either the Wisconsin or the Delaware plan, discriminatory taxation would be eliminated. But when, as is the fact, some follow the one and some the other, inequitable results follow. A resident of Wisconsin who received his income from property in Delaware would pay personal income tax to neither state, while his neighbor, who received his income from property in Wisconsin, would pay income tax to Wisconsin. Most of the states, however, follow what is usually called the New York scheme which is a combination of those used by Wisconsin and Delaware. Residents pay a tax on all income, and nonresidents pay upon income derived from sources within the state. In this case, if a resident of New York derives his income from property in Wisconsin, he pays a tax both to New York and Wisconsin, while his neighbor with an income derived wholly within New York pays only to New York. Obviously other combinations can and do occur, each of which is discriminatory to

individuals, although—as will be indicated later—relief may be given through a reciprocal crediting arrangement.

There are, of course, rational grounds for adoption of the different bases. A debtor state, as Wisconsin was in 1911, stands to gain by taxing income arising within the state; whereas a creditor state stands to gain by using the Delaware (or New York) basis. To make a decision in the light of a creditor-debtor position is, however, to put aside the question of equity. Any modern version of the ability theory calls for taxation of incomes on the basis of residence, so that individuals are taxed on their entire net incomes. In defense of taxing personal income on the basis of origin, one can, indeed, advance the benefit theory. A nonresident does receive protection to, and provision of services for, his property in the state where the property is located. But the benefit theory does not provide an acceptable basis for taxation of personal income, and the actual practice of states which tax on the basis of origin is inconsistent with the benefit theory. For instance, progressive rates can be defended only by the ability theory, since progression makes sense only when applied to the *total* net incomes of individuals. Yet many states use progression and also tax on the basis of origin. A resident of Wisconsin with an income of $12,000 a year, half of it derived from outside the state, pays at the progressive rate appropriate to $6,000, while his neighbor, with the same income entirely of Wisconsin origin, pays at a higher rate appropriate to an income of $12,000. Thus the application of progression in this way to partial incomes means that an income pays less according to the number of segments into which it is divided. And to apply a personal income tax only to income from sources within the state, exempting income from outside sources, is to give an incentive to out-of-state investment. Even if this is taxed by the foreign (i.e., the out-of-state) jurisdictions, the reduction in the scale of progression is still an inducement. Since the people most likely to invest externally are those with substantial incomes, the unwisdom of progressive taxation on the basis of origin is increased.

The plan of taxing residents on all income and nonresidents on income from within the state is obviously unfair. In New York, however, it was coupled with a crediting device whereby a person could deduct from the New York tax the same proportion of the tax payable in another state as income taxable in New York

bears to the total income upon which a tax is payable in the other state, provided the other state reciprocates.[8] The immediate drive behind the New York scheme was the fact that many individuals earn their living in New York City and commute to residences in New Jersey and Connecticut, both of which are non-income-tax states. To tax only the income of residents would be to encourage commuting and would be unfair to the citizens of New York. Here is, perhaps, the most obvious case of where state lines have affected the basis of income tax, and the state affected is one of the strongest in the union. No spur of urgent fiscal need made it reach outside its borders.

The device of the reciprocal credit does away with the most serious type of discrimination and it has been adopted in many state income tax statutes.[9] It does not, however, do away with the discrimination arising from segmented incomes.[10] And it obviously increases both the compliance costs of the individual and the administrative costs to state officials handling the returns of nonresidents who pay no tax, or a small tax, and who live in a reciprocating state. One might be tempted to deduce that a complete extension of reciprocal credits by all states would enable their abolition. But this is not within the bounds of possibility. So long as the rates and exemptions of personal income taxes are different in different states, some states stand to gain or lose by abolition of reciprocal credits.

The National Tax Association has for many years tried to bring the states to agreement about the basis upon which individual incomes should be taxed. Its "model plan," framed in 1919 and revised in 1933, recommended that the levy should be upon residents according to their entire net incomes.[11] The plan has had considerable influence and it pointed out with great cogency that, in a federalism, the states have a duty of exercising mutual forbearance in the application of taxation. But with respect to personal incomes the temptations of particularism have been too great to resist, and agreement concerning the proper theoretical

[8] Or does not tax income of New York residents at all.

[9] According to Blakey and Johnson, p. 358, eleven states allow a credit to residents for income taxes paid on the same income in other states, and twelve to nonresidents.

[10] National Industrial Conference Board, *State Income Taxes* (New York, 1930), II, 102–03.

[11] *Proceedings of the National Tax Association*, 1933, especially pp. 365–74.

basis has never been secured. A committee of the Tax Policy League in 1935 declared that to define income according to the domicile of the recipient "inflicts a hardship upon the poorer states having a large amount of absentee ownership and confers a clear bonus on the wealthier states and those states affording favorite residential havens for the possessors of large wealth." [12] This blunt statement brings out the conflict in the state point of view and therefore the inherent difficulty in eliminating discrimination.

Failure to agree upon a uniform basis is the most striking defect in state taxation of personal incomes, but other grounds of conflict remain and because of them the levies differ in very many details. These differences mean that taxpayers have to make out returns on a variety of forms. Some of this variation springs from nothing more significant than the fact that, years ago, when the tax was introduced, a start was made in a certain way. At once this provides an obstacle to change because of the inertia of legislators and administrators, and because uniformity with some other state or states would be an immediate convenience only to the small number of taxpayers who make out more than one return. The greater number of taxpayers, who make out only one return and who are familiar with it from past use, would be inconvenienced temporarily by a change. And how decide on the make-up of the ideal return? Standardization is desirable, but what is to be the standard? The cost of compliance is increased also because the regulations and rulings which stem from different income tax laws—and even from similar laws—take dissimilar roads. Every bypath, while it may increase the desirability of reform, also increases the obstacles.

THE CREDITING DEVICE

As a remedy for state conflicts in taxation of personal income, federal intervention by extension of a crediting device has received a good deal of attention.[13] Application of this device would, however, raise special political difficulties. The effect of

[12] Report of the Committee of the Tax Policy League: *The Plan of State Income Taxation in the Revenue Systems of the States* (New York, 1935), p. 10.

[13] The Interstate Commission on Conflicting Taxation made a careful examination of this scheme, and what follows depends a great deal upon its discussion. See its 1935 Progress Report, *Conflicting Taxation* (Chicago: Council of State Governments, 1935), chapter vii.

crediting is to put direct pressure upon the states to levy a tax at least sufficient to absorb the credit. When used with respect to death duties only two states, Florida and Nevada, were directly affected, since all the others already were in the field. At present, however, one-quarter of the states do not tax personal income and therefore the credit would do them no good. Inevitably pressure would develop for enactment of income taxation in these states, and while a student of public finance might approve, the political repercussions would be serious, particularly in states the constitutions of which do not now permit this step.

One way to get around this difficulty would be for the federal government to agree to accept as credits against income tax payments to it, the receipts from state taxes other than those on personal income. The administrative difficulties which this would create are very obvious. And besides, to adopt such a plan would be to give up the aims of securing uniformity in state taxation and the reduction of multiple levies. Federal crediting could hardly be justified unless, as conditions, certain standards were specified, the most obvious of which is that a state should levy a tax on personal income. Should the federal government go further with conditions? Should it declare that, in order to secure credit, a state must tax income on the basis of the domicile of the taxpayer? Should it specify uniformity in exemptions, reporting, accounting, and administrative rulings? Unless something of this sort is done, crediting will not remedy, and it may even aggravate, the evils of multiple administration, since the whole galaxy of state officers might remain in existence and multiple returns would still have to be made out. If a state chose, or if it were forced, to make its personal income tax parallel in base, definitions, and rulings to the federal tax, then administration might become almost entirely a federal matter and the scheme would be converted into a federally-collected state-shared tax.[14]

At present the state income taxes carry very low scales of progression, while the federal tax, even before the war, had a very steep scale for the upper brackets. If, therefore, the credit were given as a *flat* percentage, no state, without a radical alteration of the tax, would be able to take advantage of it. Such an altera-

[14] After 1926 some states merely absorbed the federal credit for the estate tax by passing a parallel statute, leaving administration almost wholly up to the federal government.

tion would not, in any case, be desirable because the states as a whole should not be encouraged to make their taxes sharply progressive. A more acceptable plan would be to give a credit which was graduated inversely to the size of the individual incomes, so that a large credit, i.e., 75 per cent of the state tax, would be permitted against the federal tax for incomes below $10,000, and a smaller credit, i.e., 25 per cent for larger incomes. Too great detail in graduation of the credits would introduce complexity of administration.[15]

Such a graduated credit could be an instrument of great power. Indeed, once graduation is introduced the scheme would become more than a crediting device; it would affect the scale of progression in state income taxes and would be especially advantageous to the poorer states which have few taxpayers with large incomes. By giving large credits on small incomes and small credits on large, the federal government would reduce the amount of its collections in a poor state relatively more than in a rich one. The scheme, instead of being used merely to remove or reduce interstate conflicts, would operate so as to make an interstate redistribution of tax burdens. If, besides, federal conditions were set up which permitted credits only when the state taxes corresponded to the federal tax in their definition of income, exemptions, deductions, etc., the question would soon arise: Why have state income taxes? Why not place taxation of income entirely in federal hands and then consider in what other ways the fiscal need of the states arising out of the loss of this source of revenue could be met?

FEDERAL COLLECTION AND STATE SHARING

This proposal eliminates all questions of conflicting taxation in taxation of personal income, while it raises in acute form the question of the proper basis for sharing. If domicile is accepted, the wealthy states would receive the lion's share, and yet no other basis can be plausibly defended. Instead, arbitrary decisions would have to be framed and applied, and it appears certain that such decisions would be constantly attacked and frequently altered. Rather than face such a result, the wiser step would be

[15] The Committee on Conflicting Taxation for this reason suggested that the dividing line be set at $10,000, with incomes below this level receiving a credit of 75 per cent and those above a credit of 25 per cent.

to accept federalization as part of a major revision of federal–state fiscal relations, with adjustment to the states in some other fashion—federal relinquishment of other sources of revenue, an extension of federal grants, or enlargement of federal functions.

OTHER SCHEMES

The Committee on Intergovernmental Fiscal Relations which reported to the Secretary of the Treasury in 1943 took a conservative position in this respect. It felt that "a very large measure of coördination in the income-tax field has already been achieved through the deductibility features of the Federal and many State laws." [16] This deductibility of the state tax in the federal law is a sort of subsidy which gives "a substantial advantage to the income-tax States." [17] The Committee is hopeful also concerning coöperation in administration by exchange of information, joint returns, joint credits, etc. One need not deny the desirability of these features to feel that their promise is inadequate.

Taxation of Business

(particularly corporate income)

> A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society.[18]

In an important sense taxation of business is an American device. Many countries, especially unitary countries, do not regard business as taxable as such; they have tended to levy business taxes principally as a method for collection at source.[19] But in the United States neither the federal government nor the states have accepted this approach. The federal government, in addition to the corporate income tax, has imposed levies on excess profits, capital stock, undistributed profits, as well as other minor

[16] *Federal, State and Local Fiscal Relations*, p. 437. The committee consisted of Harold M. Groves, Luther Gulick, and Mabel Newcomer.

[17] *Ibid.*, p. 441.

[18] Justice Frankfurter in *Wisconsin et al.* v. *J. C. Penney Co.*, 311 U.S. 435, at 444.

[19] Recently there has been a turn toward taxation of business as such.

taxes,[20] and no clear or consistent explanation for the variety can be stated. The states also have taxed business, and especially corporations, in a bewildering number of ways.

THE BASIS OF FEDERAL TAXATION OF CORPORATE INCOME

Neglecting minor federal levies on corporations, let us look briefly at the tax on corporate income. This federal tax was originally very different from that which now exists, and one of the most important differences is that originally the tax was a kind of addition to the personal income tax rather than a business tax. In 1913, and for several years after, the rate on corporate income corresponded to the normal rate on individual incomes and this tax could be credited in returns of individual income so far as dividends were received. If, then, a corporation distributed all its earnings as dividends the corporation income tax in effect did not exist. The tax was a method of collecting at source from a certain type of individual income. But after 1917 the equivalence between the rate on corporate income and the normal rate for individuals ceased, the former being always higher. Then in 1936 the individual credit against the normal tax was abolished. In these ways the corporate income tax was converted into "an objective, impersonal business tax, restricted to corporations only." [21]

This has injured the equity of the personal income tax. To tax corporate income as such at a given rate (or set of rates) is to make no adjustment to the differing incomes of the owners of the corporation. If the rate of the corporate tax is twice that of the normal tax on individual income, and if all the earnings of a corporation are distributed, then low-income persons are penalized, so far as they receive these dividends. If corporate earnings are not distributed, the effect is to subsidize this sort of saving as compared with other kinds, and also to provide an avenue of evasion for wealthy persons in control of corporations. For some years Congress has fumbled for remedies—notably through the undistributed profits tax of 1936—but so far without success.

The most promising method of reform has been suggested by the majority of a committee of the National Tax Association,

[20] The surtax on personal holding companies, the surtax on corporations improperly accumulating surplus, the tax on foreign personal holding companies, etc.

[21] *Proceedings of the National Tax Association*, 1939, p. 577.

which in 1939, after a careful survey, recommended the application of the personal income tax to corporate savings by taxing "individual shareholders upon their distributive shares of corporate profits." [22] The purpose is to reach undistributed as well as distributed profits, and to do so by tax rates which are appropriate to the total net incomes of individuals. The effect of this proposal would be to integrate the corporate with the individual income tax. The former would exist merely as a means for prepayment of the latter. The committee recognizes, however, that an additional business tax, resting upon the benefit rather than the ability principle, may be justifiable. As will appear later, it is upon the benefit principle which state business taxes must rest, because the states have insisted upon taxing business for the privilege of doing business within their boundaries and they have not integrated these taxes with taxation of personal income.

There is little likelihood that Congress will soon respond to the proposal just outlined, and it should, therefore, be kept in mind that the present federal tax on corporate income is a sort of business tax (restricted to corporations) which introduces serious inequities into federal taxation of personal incomes. But this same tax is generally free from defects which can be charged against state business taxes, since it does not discriminate among corporations according to their geographical location or to the type of activity in which they engage.

THE BASIS FOR STATE TAXATION OF BUSINESS

Whatever may be the reasons why the federal government has never accepted the principle that business should not be taxed as such, there is an obvious reason for its rejection by the states. Acceptance of the principle would mean that business firms would be regarded merely as conduits which conveyed income to individuals. Business income as such would not be taxed. This would mean that a state could not reach the income earned by its corporations which went to nonresidents, and the unacceptability of this proposition to state governments is clear. It runs counter to the theory that business owes taxes to the jurisdiction from which it derives public services, and many people who discard the benefit theory in any discussion of personal taxation maintain

[22] *Ibid.*, p. 579; pp. 544–61.

that it has a definite place in business taxation. This was the stand taken, for example, by the committee of the National Tax Association which framed the "model plan." It recommended taxation of personal income at the place of domicile, and taxation of business "for the benefits it receives" by the jurisdiction where it carries on business. "The decisive consideration in favor of a special business tax" [23] was the need of reconciling the conflicting claims of the different states in the Union. Those states which objected to the recommendation that no attempt be made to reach the income of nonresidents by the personal income tax might, it was hoped, be pacified by the permission to secure a revenue from a business within their borders even though all the owners of the business might reside elsewhere.

Here, then, is a theory which justifies taxation of business as such; a theory also to which the practice of the American states might be tailored with a great improvement over what now exists.[24]

Actual state taxes on corporations fall broadly into four categories. (1) Since corporations, almost without exception, are creatures of the states, the states have long taxed them for the right of *organization;* and an organization tax is one levied on a domestic corporation at the time of incorporation. (2) Each particular state has also taxed foreign, i.e., out-of-state corporations for the right of *entering* its boundaries; and an entrance tax is one levied on a foreign corporation at the time of entry into a state other than that of incorporation. (3) The states have, besides, levied general corporation taxes on the right of *doing business* within their boundaries, and these are called "franchise" taxes when they refer to an annual levy on domestic corporations, and "privilege" taxes when they refer to an annual levy on foreign corporations.[25] (4) The states have, finally, levied a variety of special taxes on particular types of corporations—these often being *in lieu* taxes.

A discussion of the ways in which states have taxed corporations for organization and entrance, and for the right of doing business cannot be attempted here. It is common knowledge that the

[23] *Proceedings,* 1939, p. 391.

[24] The theory has, however, no important significance for the federal government, because the problem of non-resident owners should have little part in shaping federal taxation of corporations.

[25] National Industrial Conference Board, *Taxation of Business Corporations* (1931), p. 16, p. 19.

methods are extremely diverse and that this variety adds to the cost of doing business. Most commonly organization and entrance taxes are based on paid-in capital stock. The courts, while holding that the right of a state to impose organization (and also franchise) taxes upon their own corporations is very little incumbered by constitutional limitations, have been stricter with respect to entrance (and privilege) taxes. Thus a state can base an organization tax upon the total capital stock of a domestic corporation, but this sort of an entrance tax upon a foreign corporation would be invalid as an attempt to tax interstate commerce and property beyond the jurisdiction of a state. A state must base the entrance tax upon allocated stock or on capital to be employed in a state.

Annual taxes upon the right to do business in a state are fiscally much more important and the same problem of domestic *v.* foreign corporations touches them. Because the courts put restrictions upon the levy of privilege taxes some of the discrimination that might otherwise result is eliminated, but again the issue of proper allocation comes up and about this there is much disagreement.

The states vary greatly in the relative importance to them of organization and franchise taxes on the one hand, and entrance and privilege taxes on the other. Some states are lenient about the former in an endeavor to attract within their borders corporations which do a national business; others, often with little choice, have to rely chiefly upon entrance and privilege taxes.

Franchise and privilege taxes, as well as those on organization and entrance, are often based upon corporate capital. But "in at least eight states the franchise tax on corporate capital has been practically superseded by a tax on corporate income," and "in some twenty-four states corporations are subject to an income tax as well as the annual franchise and privilege taxes." [26] When corporate income is taxed as a franchise or privilege tax, a state can include elements in income which otherwise might not be constitutionally taxable.

Apart from a confusing variety in methods, the problem of conflicts in state taxation of business arises most obviously in connection with allocation. Taxes upon incorporation and entrance, as

[26] C. J. Hynning, *Taxation of Corporate Enterprise,* Monograph No. 9, Temporary National Economic Committee (1941), p. 113.

well as upon the privilege of doing business, call for allocation. In the case of domestic corporations some sort of allocation is common not because of constitutional requirements, but because states fear that otherwise the corporations might move; in the case of foreign corporations, as has been noticed, the courts have insisted upon allocation.

ALLOCATION OF CORPORATE INCOME

The difficulties which have arisen in allocation can be seen most clearly in connection with taxation of corporate income.[27] What is a fair method of allocation? A great many choices have been made by the states and the choices have often been dictated not by consideration of what would be fair to a corporation doing a national business, but by consideration of what would bring in the most revenue. Obviously it makes a great deal of difference to a corporation doing business in many states what basis is used. When the states use different bases, each selecting that most favorable to it—so far as the law allows—the tax burden of the corporation is unreasonably increased, since the various bases will add up to more than 100 per cent. Common among the bases are the value of corporation sales, of purchases, of payrolls, of property, or some combination of these.

> States in which purchasing activities predominate desire much weight given to the sales factor; and those in which manufacturing is the chief industry seek to strengthen the effect of tangible property and wage factors. The very fact that there still exists a great lack of uniformity in the methods actually in operation, is evidence of the obstacles in the way of submerging these divergent points of view.[28]

Some states have used one basis, e.g., gross receipts, for years, and then later, when many manufacturing firms were established within their boundaries, have shifted to tangible property. Such a step is self-conviction of error and bias.

A simple hypothetical example will serve to show how inequity may exist.[29] Suppose a corporation with an annual net income

[27] Thirty-six states were taxing corporate net income in 1941, six of them at progressive rates, and the remainder at flat rates. Blakey and Johnson, "State Income Taxation," p. 132.

[28] Henry F. Long, *Interstate Reciprocity in Connection with Corporate and Personal Income Taxation: Tax Relations among Governmental Units* (Tax Policy League, New York, 1938), p. 77.

[29] The example is taken from *Proceedings of the National Tax Association*, 1929, p. 156 (with correction of an arithmetical error).

of $600, with property of $1,200 distributed in three states, and gross receipts of $3,000 distributed among four states. If each of the states, in allocating income, gives equal weight to property and to gross receipts, the results are shown in Table 29, column

TABLE 29

HYPOTHETICAL ILLUSTRATION OF INEQUITIES IN TAXATION OF CORPORATIONS

(a) State	(b) Property	(c) Gross receipts	(d) Even weight	(e) Most favorable
A	$ 800	$ 500	$\frac{5}{12}$ or $250	$\frac{8}{12}$ or $400
B	300	1,500	$\frac{3}{8}$ or 225	$\frac{1}{2}$ or 300
C	100	200	$\frac{3}{40}$ or 45	$\frac{1}{15}$ or 40
D	....	800	$\frac{2}{15}$ or 80	$\frac{4}{15}$ or 160
	$1,200	$3,000	$600	$900

(d). In state A the allocation fraction will be (800/1,200 plus 500/3,000) $\div$ 2 = 5/12, and similarly in the other states. If, however, each state uses either property or gross receipts alone, taking care to choose the one which is more favorable to it, the results will be as in column (e).

No remedy can be expected by judicial interpretation. In 1920 the Underwood Typewriter Co.[30] argued that the Connecticut formula, based on the ratio of property within and without the state, was grossly unfair. The company had 47 per cent of its real estate and tangible personal property in Connecticut, while 80 per cent of its gross earnings grew out of sales outside this state. But the Supreme Court declared its unwillingness to assume that a state legislature intended to use an unfair formula, and it asserted that the taxpayer had not shown the operation of the formula to be arbitrary and unreasonable. At this very time the states were coming into the field of income taxation and the decision served to protect and encourage state ingenuity in devising methods of allocation. More than a decade later the Supreme

[30] *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113.

Court, in the Hans Rees' case,[31] did strike down a formula as unreasonable. A New York corporation, which engaged in the leather business and had factories in North Carolina, complained about the North Carolina method of allocation, resting upon real estate and tangible property. According to this formula, 80 per cent of the net income of the corporation, 1923–1926, should be apportioned to North Carolina, while the accounting records of the corporation made the figure 17 per cent. The decision of the Supreme Court was adverse to North Carolina and this indicated that a formula which departed too far from the method of separate accounting would not be tolerated. But in general the Court has been content to tolerate much that is questionable and the difficult task of proving discrimination is placed upon the corporation.[32]

The National Tax Association has labored long over a remedy. Since 1922 five committees have made proposals,[33] and the results, while enlightening, are also discouraging. The most recent committee, reporting in 1939, favored encouragement of the use of separate accounting by which the books of a corporation doing business in several states should be so kept as to show separately the income from the operations in each, and determination of the amount of the tax in accordance with this information.[34] On the other hand, an earlier committee in 1922 was critical of this plan. Certainly it is administratively complex and it cannot be applied by all corporations except by the use of fictitious accounting rules.[35] In 1933 a committee had favored use of a formula—the Massachusetts formula—based upon property, payrolls, and sales, with equal weight to each—and this would offer a convenient practical solution. Perfect fairness in every particular case is impossible, and, in this sense, any method of allocation must be

[31] *Hans Rees' Sons* v. *North Carolina,* 283 U.S. 123.

[32] A federal circuit court once declared: "Algebraic formulae are not lightly to be imputed to legislators." Quoted by Blakey and Johnson, p. 284.

[33] *Proceedings of the National Tax Association:* 1922, p. 198; 1926, p. 159; 1929, p. 155; 1931, p. 301; 1933, p. 259; 1938, p. 486; 1939, p. 190.

[34] *Proceedings of the National Tax Association,* 1939, pp. 190–236. Many more detailed recommendations cannot be considered here.

[35] A distinguished tax administrator, Henry F. Long, recently made the following comment: "There isn't an accountant in this room—and we have the cream of accountancy right here—who can't take any tax law of any single state in this union and take the accounts of his own company and make the results of his calculations bring a different result in one state than it will in another by the system of accountancy." *Ibid.,* 1938, p. 507.

arbitrary. "The formula method recognizes that, in case of unitary businesses conducted in more than one state, the net income attributable to any particular state is incapable of exact determination and accordingly is satisfied with an approximation."[36]

Substantial justice could be achieved by any one of several formulas provided only that the states would "get together as a matter of comity." Fractional allocation can be based upon factors which are easy to ascertain and measure, and in such case it will assist both the taxpayer and the administrator by giving prompt results in an economical manner. The separate accounting method, where it can be applied, does give a more accurate result and there is much to be said for its use by the federal government in dealing with foreign companies, since a national government should use empirical methods only after all other reasonable methods are exhausted. But it is administratively difficult, since it calls for an audit of returns. A business firm doing a national business which had to submit to detailed investigation by a number of states would find this very costly, and so also would the states making the investigation. It would seem, therefore, that allocation by some agreed formula would enable the states to tax business without discrimination and without putting unreasonable compliance costs upon nation-wide firms.[37]

Unfortunately such a simple solution seems no farther advanced now than in 1922. In 1939 of the thirty-two states which taxed corporate income, ten used the Massachusetts formula, and quite a number used a formula not greatly different.[38] But there are sixteen formulas in use, some states do not permit apportionment of income at all, and very many are opposed to application of a single uniform formula to all types of business. It is hard to

[36] *Ibid.*, 1939, p. 221, remarks of F. U. Keesling. The earlier committee in 1922 had observed: "There is no one right rule of apportionment, notwithstanding that there are probably a number of different rules, all of which may work substantial justice. For the present purposes the only right rule of procedure is a rule on which the several states will get together as a matter of comity. Getting together by the uniform adoption of some equitable method and finding the right rule of apportionment are, in our opinion, synonomous." *Ibid.*, 1922, p. 202.

[37] The advantages of a uniform formula have been summarized as follows: "(1) No corporation would be taxable on more than 100% of its income; and yet no corporation operating only in states using the formula could escape taxation on 100% of its income; (2) bookkeeping methods and preparations of returns for corporations doing business in several states would be simplified." *Proceedings of the National Tax Association*, 1939, p. 197.

[38] *Ibid.*, p. 193. See also Blakey and Johnson, "State Income Taxation," pp. 285–86.

resist the conclusion that the states by themselves will never reach even approximate agreement upon a single formula, and the idea that a series of formulas will be adopted, each appropriate to a type of business arranged in a uniform classification in all the states, is even more remote. The states wish to classify business according to ways which will produce most revenue for them, and their argument that different types of corporations require a different formula is usually dissimulation. Uniformity in formulas even with respect to the *same* types of business has not progressed. There is, besides, the complication that the same corporations do not engage in the same type of business in every state, and that therefore the states would not give the same corporation the same classification.

It should be noticed that businesses, feeling themselves injured by unfair state use of allocation, have themselves devised methods of escape. One of the most widely recognized methods is for a firm to organize an affiliate—perhaps a sales corporation—in some state which does not tax corporate income at all or which taxes it leniently. Income can be diverted from the state of high to the state of low taxes, or intercorporate sales can be arranged so as to secure profits (or losses) in the most suitable state.[39] Tax-dodging is not a nice spectacle, but sometimes there is a vicious action and reaction between taxpayer and tax-administrator. The former, irritated at the inequity of the practices of the latter, resorts to avoidance; the latter hastens to get legislation or to devise rules which will block avoidance.[40] Recrimination and litigation

[39] See Roswell Magill, "Allocation of Income by Corporate Contract," 44 *Harvard Law Review* 935 (1931).

[40] By its general corporation tax, Wisconsin for many years taxed foreign corporations on that part of their earnings attributable to Wisconsin activities, using an allocation formula based on sales, tangible property, and manufacturing or selling cost. Recently it enacted a new tax on the privilege of declaring and receiving dividends out of income derived from Wisconsin, using the same method of allocation as in the general corporation tax. The purpose was, of course, to reach dividends paid to nonresident stockholders. By a 5–4 vote the Supreme Court reversed a decision of the state court holding the tax unconstitutional. Justice Frankfurter, speaking for the majority, declared that the simple issue was: Has the state given anything for which it can ask a return? And his answer was affirmative. He presented this broad rule: "A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." *Wisconsin, et al.* v. *J. C. Penney Co.*, 311 U.S. 435, at 444. Chief Justice Hughes, Justices Roberts, McReynolds, and Reed argued that Wisconsin was reaching outside its boundaries.

follow, and whatever the outcome the nation as a whole is worse off.

Thus it seems that we have here a real defect of federalism. Business, which not many decades ago was predominantly intrastate, has spread and will continue to spread across state lines. The jurisdiction of the states, when they attempt to tax this business, is supposed to stop at state lines, and reasonable rules are available which would define the proper tax base of each state in the earnings of a multi-state business. But many of the states have been unwilling to accept the rules, and the result has been discrimination, excessive costs of tax administration, multiplication of litigation, and victimization of exposed businesses. These costs are not easily perceived by the the public, but they are so serious in their effect on the national economy that federal intervention may be appropriate.

FEDERAL INTERVENTION

In recent years the failure of voluntary state agreement has raised the issue of federal compulsion. One plan is that the federal government should utilize the tax-crediting device so as to specify a uniform allocation formula. For some people such a diminution in the power of the states to tax as they please appears wrong.[41] But there are other and less disingenuous difficulties. State methods of taxing corporations are diverse and it would be necessary to decide which should be accepted for credit against the federal tax. To accept all or most of the existing state taxes on corporations would be to exert no pressure for uniformity in methods of taxation, or in recording and reporting; and it would make administration of the credits extremely complicated. On the other hand, to define narrowly the state taxes acceptable for crediting would be to force many states to scrap existing methods. Obviously it is difficult to say, without detailed study, how far and how fast the federal government should go in prescribing standards, or how generous the credits would have to be to induce the states to conform to any given set of standards.[42]

[41] See *Proceedings of the National Tax Association*, 1938, p. 491.

[42] In 1935 the Interstate Commission on Conflicting Taxation tried to put together some illustrative material and found serious obstacles. The figures for the federal corporation income tax show where collections are made, but they give no indication of origin in the different states. Credits based on collections would be quite unfair.

Another suggested remedy is that Congress pass a law prohibiting multiple taxation through state corporation taxes measured by income, and at the same time set up a committee to prescribe methods of taxation which will be permissible. Supposing the obvious constitutional and political difficulties to be surmounted, this proposal would be less revolutionary in its effect upon existing practices than any other. An effective committee could work out and define what constituted multiple taxation and permit such diversity in methods of taxation as seemed desirable.

A proposal restricted to a particular type of business has recently been proposed by a committee appointed by the Civil Aeronautics Board at the instance of Congress. The Supreme Court in *Northwestern Airlines, Incorporated* v. *State of Minnesota* [43] upheld the right of Ramsey County, Minnesota, to levy a property assessment on the entire fleet of aircraft owned by the Northwest Airlines, a Minnesota corporation. Other states, of course, taxed portions of the fleet on the theory that these portions had a taxable situs within their boundaries.

In this decision the Court split five to four and three of the judges in the majority wrote separate opinions. These majority opinions, however, expressed at least two common beliefs: that rules of apportionment which were applicable to land commerce should not be carried over to the new and different mode of transportation introduced by the airplane, and that the Congress, rather than the courts, should make the general rules concerning taxation of interstate commerce.[44] The minority opinion, de-

[43] 322 U.S. 291.

[44] Justice Frankfurter said (p. 298): "Congress of course could exert its controlling authority over commerce by appropriate regulation and exclude a domiciliary State from authority which it otherwise would have because it is the domiciliary State."

Justice Black said (p. 302): "The differing views of members of the Court in this and related cases illustrate the difficulties inherent in the judicial formulation of general rules to meet the national problems arising from state taxation which bears in incidence upon interstate commerce. These problems, it seems to me, call for Congressional investigation, consideration, and action. The Constitution gives that branch of government the power to regulate commerce among the states, and until it acts I think we should enter the field with extreme caution."

Justice Jackson said (p. 302): "Congress has not extended its protection and control to the field of taxation, although I take it no one denies that constitutionally it may do so. It may exact a single uniform federal tax on the property or the business to the exclusion of taxation by the states. It may subject the vehicles or other incidents to any type of state and local taxation, or it may declare them tax-free altogether. Our function is to determine what rule governs in the absence of such legislative enactment."

livered by Chief Justice Stone, declared that

> the Minnesota levy imposed an unconstitutional tax on petitioner's vehicles of interstate transportation in violation of the commerce clause. . . . It subjects a new and important industry to state tax burdens, essentially discriminatory in their effect on interstate commerce, to which other interstate carriers are not subject and which it was the very purpose of the commerce clause to avoid.[45]

This positive conclusion of the Chief Justice was disturbing to the Congress. It directed the Civil Aeronautics Board to develop "means for eliminating and avoiding, as far as practicable, multiple taxation of persons engaged in air commerce and their employees," thereby taking a first step toward acceptance of the invitation given frequently by the Supreme Court in recent years to resolve the problem of multiple taxation of interstate commerce by legislative action. The Civil Aeronautics Board reported on April 5, 1945.[46]

The report recognizes that multiple taxation can be rectified "either by assertion of exclusive Federal jurisdiction or by attempting to modify the tax practices of the several states."[47] The latter alternative is favored. But the states are to be forced to use a method of allocating their tax base—whether this was income, or property, or gross receipts[48]—so as to avoid multiple taxation. The compulsion is to be exercised by Congress which is to

> prescribe a method of apportioning the several tax bases used by the States and localities so as to insure an equitable distribution of the entire tax base properly attributable to continental United States—no more and no less—among the States in which an air carrier's operations are conducted. The rule of apportionment adopted should be simple; it should establish taxable situs in all States where scheduled stops are made. This may be accomplished by an apportionment formula which reflects property used and business done in each of the States of operation.[49]

For net income taxes the recommended formula

> is comprised of (1) originating and terminating passenger, freight, and express tonnage with a weight of 40 percent, (2) originating passenger, freight,

[45] *Ibid.*, p. 308, p. 320.

[46] U.S., 79th Congress, 1st session, House Document No. 141: *Multiple Taxation of Air Commerce* (Washington, 1945).

[47] *Multiple Taxation of Air Commerce,* p. 4.

[48] These were, in this field, considered to be the state and local taxes susceptible to double taxation.

[49] *Multiple Taxation of Air Commerce,* p. 5.

and express revenues assigned to the State of original departure (or of connection in the case of off-line transfers) with a weight of 40 percent, [and (3)] ground pay rolls (i.e., total pay rolls excluding flight crews) with a weight of 20 percent.[50]

The Congress is to provide also for a federal agency "to interpret and administer the formulas." [51]

It remains to be seen whether or not the Congress will act on these recommendations. Undoubtedly the fact that the aviation industry is new, and that at present existing and local tax systems would not be upset by the recommendations, will encourage action. On the other hand, the steps contemplated would be a precedent and as such they will be opposed by the states. To those interested in reform of federal–state fiscal relations, however, the precedent will be regarded as in the national interest, particularly in view of the manifest unwillingness of the Supreme Court to give protection against multiple taxation. If Congress will legislate with respect to aviation, it may be encouraged to seek remedial action against multiple taxation of business as such.

The most drastic proposal which has received attention is that the federal government assume complete responsibility for taxation of corporations—at least beyond levies which fiscally are of little importance. The problems raised by the existence of state boundaries would then disappear because state jurisdiction would disappear. Multiple and conflicting taxation of corporations would be eliminated, cost of administration would be reduced, and compliance costs would be lessened.

A major issue crops up at once: if the states give up this taxing power to the federal government, is the federal government to act merely as a collector for them (as well as for itself), and if so, what amount is to be collected and on what basis are the proceeds to be distributed? Here many of the problems are definitely on the political, rather than on the technical plane.[52]

Following the precedent of certain state-collected locally-shared taxes, it is natural to think of a federally-collected state-shared

[50] *Ibid.*, p. 6.

[51] *Ibid.*, p. 7.

[52] R. M. Haig, "The Coördination of Federal and State Tax Systems," *Proceedings of the National Tax Association*, 1932, pp. 231–32.

tax.[53] If the federal government collected for purposes of sharing an amount *equal* to the total of the state collections which were to be suspended, how should this amount be distributed? To use origin would be to give some states much more, and other states much less, than they had collected for themselves. To use some other basis, e.g., population, would be to convert the distribution into a sort of unconditional subsidy.

It may, however, be suggested that the federal government, besides collecting its own revenue from this source, should permit the states individually to indicate the rate (or rates) which they wished the federal government to levy on corporate income originating within their boundaries. Against corporate income in state A the federal government would levy its own tax plus a specified state rate; in state B the specified rate would be different. In short, the states would have the right to make additions to the federal rates. Uniformity in this respect would be sacrificed in order to enable the states to meet revenue needs which are diverse.

A proper appraisal of this scheme would require calculation of the additions to the federal tax which the different states would have to request in order to secure amounts equal to what they now collect themselves. Beyond doubt, the range of additions would be very great. Some states have little corporate income within their boundaries and part of the explanation of the discriminating devices which they use lies in this fact. The proposals just considered would debar these unfortunate practices, but they would not relieve poor states from their fiscal need. And this indicates once again the significance of the broad generalization that a remedy for the existing conflicts and difficulties in federal–state fiscal relations cannot be found in reform of a single tax or, indeed, in any single aspect of federal–state finance. What is necessary is over-all revision, so that the opposition of particular states to a particular change may be submerged by the general acceptability of an entire plan.

[53] Mayor La Guardia has proposed a scheme of this sort, coupled with a crediting device. "If," he said, "the state enacts a tax up to a certain amount of the federal income tax (the formula, of course, must be worked out), full credit then is given in payment of the federal tax, the federal government collecting the whole and remitting to the state its portion. If the state fails to impose such a tax, the state then gets no reimbursement, and the Federal Government takes all." ("A Uniform System of Taxation," *Tax Magazine,* March 1940, p. 137.) He speaks strongly of the desirability of "uniformity" in taxation throughout the Union, but with no apparent appreciation of the complexity of the problems.

State Taxation of Particular Classes of Corporations: (a) Insurance; (b) Banks

Differences in the fiscal resources and programs of the states would lead to taxation of business at different rates even if a uniform basis was used. For this reason, therefore, the same type of business is taxed more heavily or more lightly in one location than in another, and the foregoing pages have shown that additional variations occur because of discriminating practices. Within the same state certain types of business may receive kindly or severe treatment for a great number of reasons, and although sometimes the result is deliberate, in some cases it stems from historical accident. It will help to indicate the variety of forms of special state taxation of business if two types commonly exempted from the general corporation tax are singled out for brief explanation.[54]

INSURANCE

Insurance as a type of business was early singled out for lighter taxation than other business. For many years the predominant form of taxation of insurance companies has been that upon premiums, and it would seem that here the states have attained substantial uniformity. A survey of the rates of taxation also indicates considerable uniformity and stability, and credit for this has sometimes been given to the existence of reciprocal and retaliatory clauses in the tax statutes. The retaliatory provision, used by about forty states, provides that a given state—A—will tax foreign insurance companies at the same rates and in the same manner as domestic, except that "if any other state—B—imposes upon A's companies a higher tax, B's companies shall be taxed in A by B's law."[55] "Under the reciprocal plan—a state enacts no specific mandatory taxes to be imposed upon foreign insurance companies but provides that such companies shall be subject to the same special tax laws as are imposed by the state chartering such companies."[56]

It is the contention of students that while this sort of provision may have accomplished something toward securing stability and

[54] A considerable number of non-profit-making organizations are given special treatment, but such action is of little fiscal consequence.

[55] K. M. Williamson, "Reciprocity and Retaliation in Insurance Taxation," *Proceedings of the National Tax Association*, 1938, p. 463.

[56] *Ibid.*, p. 462.

uniformity in the *rates* of taxes, the apparent uniformity in the form of taxation, i.e., premiums, is a delusion.[57] There is, it appears, confusion as to the classification of premiums subject to the tax.

Certain states declare premiums collected within the state to be the tax base; others take premiums on business done in the state; others "premiums received from residents"; another makes its tax base all first premiums on business written in the state and all renewal premiums received in or out of the state on lives in the state. Another taxes all premium payments received in the state or remitted from the state to the home office; and finally, in Vermont, domestic companies are taxed on such of their gross premiums as are not taxed elsewhere.[58]

Clearly discrimination has not been prevented, and compliance costs have been aggravated. The retaliatory and (reciprocal) provisions

themselves increase the lack of uniformity by importing into a given state for the taxation of the foreign corporations the multiple bases of taxation employed by the respective chartering states of the corporations doing business within its borders. The result is that the several competing corporations within a state are subjected to these varying bases of rates of taxation, requiring different methods of reporting.[59]

Thus whatever may be the accomplishments of retaliatory (and reciprocal) provisions in keeping the states in line with respect to the *level* of taxation, their defects in adding to the complexity of administration and in definitions of the tax base are more than an offset. It is the hope of some that interstate coöperation through the National Association of Insurance Commissions, the members of which are usually the administrators of laws taxing insurance corporations, together with the Council of State Governments, may solve these problems.[60]

BANKS

The creation of the national banking system served to bring about uniformity in taxation of banks, and for many years after 1864 this uniformity contrasted strangely with the diversity which

[57] Williamson, p. 467; P. L. Gamble, *Taxation of Insurance Companies* (Albany, 1937), p. 25.

[58] Gamble, p. 473.

[59] Williamson, p. 473.

[60] The Supreme Court in 1868 (*Paul* v. *Virginia*) held that insurance was not commerce. Hence it is not subject to federal control.

prevailed in state taxation of other types of corporations. The significance of national banks in this respect was that they were federal instrumentalities. Congress prescribed a pattern for their taxation which had to be followed by the states. These banks could, so Congress indicated, be taxed on their real property "to the same extent, according to its value, as other real property is taxed"; and the holders of national bank shares, i.e., intangibles, might be taxed upon these at a rate no greater "than is assessed upon other moneyed capital in the hands of individual citizens" of a state, while shares owned by nonresidents were to be taxed only at the place of location of the bank.[61]

For nearly sixty years the courts meticulously insisted upon uniformity in the form as well as the substance of state and local taxes upon national banks; and this uniformity applied also in large measure to taxation of state banks, because lighter taxes on state banks would have been unconstitutional and because heavier taxes would have persuaded them to take out national charters.[62]

Meanwhile, in the twentieth century, a number of states began to reform the general property tax. Some adopted a classified property tax by which intangibles were taxed at a low flat rate. Other states gave up taxation of intangibles under the general property tax and turned to taxation of income. Despite these shifts, the tax on bank shares was generally retained without alteration, the belief being that, so long as the shares of national banks were taxed on a basis of equality with those of other state banks, no charge of unconstitutionality would be sustained. "Other moneyed capital," referred to in the federal statute, was believed to be that employed by state banking institutions.

This confident belief was rudely upset by the Supreme Court in 1921 [63] when it declared in effect that "other moneyed capital" included all sorts of private investments which came into competition with the capital of national banks in the money market. At once the tax systems in about eighteen states which had ac-

[61] These are the provisions as of 1868, which became section 5219 of the Revised Statutes prior to 1926.

[62] More lenient treatment by the states in aspects other than taxation has served to hold banks under state charters. But disproportionate taxation of state banks has been checked by the obstacle of the fourteenth amendment. See J. B. Woosley, *State Taxation of Banks* (University of North Carolina Press, 1935), p. 123.

[63] *City of Richmond* v. *Merchants National Bank of Richmond*, 256 U.S. 635.

cepted a classified property tax and in about twelve states which had exempted intangibles from the general property tax (taxing the income from them by an income tax) were endangered.[64] The banks in many states indicated an intention of forcing modification of the taxes on them in the light of the court decision. States with the classified property tax might reduce the rates of the tax on bank shares to the lower rates on "other moneyed capital," or they might revert to the general property tax. States which taxed income might also revert or follow certain other alternatives. In all cases, however, a sharp loss in bank taxation was threatened.

Naturally there was a vehement demand from the states that section 5219 be amended. Were they to be forced by federal legislation as interpreted by the Supreme Court to revert to inferior methods of taxation or to lose revenue which they had long received? Why should not the offending section be repealed? Why should it be presumed any longer that the national banks needed special protection against state taxation? Why should not the states be permitted to place all banks—national and state—in one group for purposes of taxation? To some of these queries the bankers soon gave an answer. They insisted that to segregate banks in a special group would be to expose them to excessive and discriminatory taxation because of a deep-seated antipathy against banks not seldom made manifest in state legislatures. The national banks argued further that, as the foundation of the Federal Reserve system, they still needed special federal protection.

In 1923 and 1926 section 5219 was amended to permit two new alternative types of taxation: (1) a tax upon dividends or (2) a tax upon net income (or an excise measured by net income).[65] Moreover, the provision with respect to taxation of shares was altered with the intention of restricting the meaning of "other moneyed capital" so as to refer only to that employed in banking. In short, the effort was to restore the meaning which

[64] Even in states which had kept the general property tax there was danger of litigation. See Woosley, p. 53.

[65] This alternative led to other interesting and confusing litigation. A question arose in Massachusetts whether the income which a corporation derived from all sources, including tax-exempt securities, could be used as a measure. In *Macallen v. Commonwealth of Massachusetts,* 279 U.S. 620, the Supreme Court said this could not be done, but this decision has since been reversed.

the phrase had before the Richmond decision. But this also was rejected by the Supreme Court.[66]

The action taken by the states need not be noticed in detail, although it is curious to observe that many of them did nearly nothing—they continued to levy and administer taxes on shares, usually at lower rates than before, which could have been invalidated by litigation.[67] State officials, dissatisfied with the loss in revenue forced upon them by the new arrangements, pressed Congress to give them still more freedom in taxing the banks. But opposition from the bankers, coupled with disagreements among the states about what was wanted, stalled this campaign.

Here then, is an instance where the existence of a group of federal corporations, subject to state and local taxation only within broad boundaries specified by Congress, governed and brought uniformity in taxation of all banking corporations. The safeguards provided were certainly necessary in 1863 and they did not, for many years, put any real impediment upon state and local taxation. Indeed, it seems that, when the general property tax was in wide use, the banks were somewhat overtaxed. But as the general property tax was replaced by newer methods of taxation, the federal restrictions became inappropriate. Yet they were not altered. Instead the states resorted to legal improvisation in the belief that what they did was safely consititutional, and that it was undesirable to ask Congress to alter section 5219 in advance of proof that its provisions were a hindrance. Then in 1921 it turned out that this improvisation conflicted with the protection which Congress had given the national banks. State revenue

[66] *First National Bank of Hartford* v. *Hartford,* 273 U.S. 548, and *Minnesota* v. *First National Bank of St. Paul,* 273 U.S. 561. Still later the Supreme Court in *Montana National Bank* v. *Yellowstone County,* 276 U.S. 499, said that, in states which taxed national bank shares under the general property tax, *assessment* at a higher ratio than other intangibles was discrimination.

[67] H. M. Groves, *Financing Government* (New York, 1939), p. 299, gives the following classification concerning bank taxation as of July 1937:

Kind of tax	Number of states
1. Real estate	48
2. Additional taxes	
A. Bank shares	34
B. Net income	2
C. Bank dividends	1
D. "According to" or "measured by" net income (franchise)	10

systems were disturbed and almost all banks made windfall gains through an easing of the taxes which they bore.

From this complicated story it is hard to draw a moral. Multiple taxation of banks has been circumvented and that must be counted as a gain. But against it must be set an intricate record of litigation and disturbance to state revenues after 1921. An aggressive state agitation for a remedy had little success, not because Congress was unreceptive, but because of state inability to agree upon what the remedy should be.

INCOME TAXATION—JURISDICTIONAL TRANSFER

The inequities and the difficulties which arise in state taxation of income, personal and business, have led to the proposal that this field of taxation be left entirely to the federal government. To this proposal a very important—probably the most important—objection has been that, if this were done, the states would be left with inadequate revenues from which to meet their expenditures. This objection, be it noted, is not to the merits of the tax transfer by itself, but to certain related consequences. If, in some manner, these consequences could be cared for, the transfer might be examined on its merits. In what follows the assumption will be made that the two issues are separable.

In any industrial nation income taxation should be the most important source of revenue for the national government. No other tax can be so nicely adjusted to the circumstances of individual taxpayers; no other tax, year after year, can be so powerful a fiscal instrument; no other tax so lays bare both the direct burdens it imposes upon taxpayers and the costs associated with its collection. It is impossible to deny that utilization of these qualities is crippled in the United States by the existence of divided jurisdiction. Citizens with equal incomes in different parts of the nation pay the same federal tax, but they pay very different amounts in state income tax. Because of the accident of residence the *total* liability for income tax of a citizen in state A greatly exceeds that of a citizen similarly circumstanced in state B.[68] The pattern is completely erratic, so that no possible system of federal rates could be devised which would make the whole conform to a rational plan. When the federal government frames

[68] It is not necessary to explain that these differences cannot be defended in terms of governmental services provided for the two citizens.

its tax as if no state income taxes existed, clamor arises from some of the states and inevitably some brackets of taxpayers are very inequitably affected.

This sort of defect would continue even if income taxes, federal and state, were framed on parallel terms in all aspects except their rates. But of course no such parallelism exists. As has been noticed taxable income is defined differently in different states and divergent administrative rulings stem from these differences, with the result that multiple burdens fall on some incomes and that both cost of administration and cost of compliance is swollen. If income tax were entirely federal then one definition of income would apply over the nation and a very important cause of multiple taxation would vanish. Agreement by the states on a definition of taxable income is literally impossible, if for no other reason than the acute difference in opinion over whether income should be taxed according to origin or residence. With respect to corporate income the difficulties in the way of equitable and efficient handling by the states are even greater than for taxation of personal income. It is commonplace to point out that modern developments in transportation and technology tend to make business ignore state lines. As a consequence, when the states attempt by taxation to tap that part of business earnings to which they think they have a claim, indefensible jurisdictional jostling takes place. Elaborate formulas are devised, stressing for each state the particular factors which appear to secure the largest immediate revenues and ignoring the most elementary concepts of fairness.

Not only does the existence of divided jurisdiction create multiple taxation, it also magnifies the costs of tax compliance. Returns have to be made to a large number of taxing authorities and these returns differ in the sort of information which is required. Cost of compliance is swollen also because the taxpayer is tempted by the differences in statutes and in regulations to try to discover loopholes which will enable tax avoidance. And when the different governments, in order to check this sort of thing, require audits and inspections of the taxpayer's accounts, obviously the cost may be considerable. Substitution of one taxing authority for many would automatically insure a reduction in amount of money which was taken out of the pockets of taxpayers and yet did not reach government treasuries.

Related to the compliance cost is excessive cost of collection. A certain minimum staff is necessary to collect income tax no matter how small the jurisdictional unit may be. A larger unit may require a somewhat larger staff to do a bigger job, but the increase will by no means be proportional. Satisfactory figures about the cost of administering state income taxes are not obtainable,[69] yet the evidence is that percentage collection costs vary inversely with the amounts of revenue collected. This conclusion is inevitable, and the absence of good statistics merely means that quantitative measurement is not possible.

The effect of the present inefficiencies in handling a major tax is to reduce the national income. Increased business costs, the the penalties imposed on investment in certain states, the disgruntlement arising from plain inequities in the use of income taxation—all operate as drains on the national income. And the inability even of the federal government to make full and effective use of income taxation forces resort to inferior taxes, and impedes —even sabotages—the development of a sound fiscal policy over the period of the business cycle. Not only is the national income depressed because of the lack of economy in tax utilization, but it is prevented from reaching its optimum level because of barriers to investment and to fuller use of what should be an important instrument of fiscal policy.

Loss of the right to levy income taxation would, of course, weaken state revenue systems. Yet, in terms of the present, the states as a whole have made remarkably slight use of their power. It is possible that in the future income taxation may be developed further by the states. On the other hand forces are at work which will hamper such a development and the recent great extension of the federal tax, particularly to lower brackets of individual income, restricts the area left for the states. It is certainly arguable that, quite apart from any transfer of jurisdictional powers, state use of the income tax cannot be much expanded. Some states with no tax will adopt it, some of those with the tax will make minor improvements, but the future of the tax must rest upon federal action.

For the four years, 1937 to 1940, state collections from income tax, individual and corporation, were about 11.7 per cent of their

[69] See *Studies in Current Tax Problems* (Twentieth Century Fund, New York, 1937), pp. 107–12; *Federal, State and Local Fiscal Relations*, pp. 306–15.

total tax collections.[70] In 1940 thiry-five states collected $370,-700,000 from this source, and this was 11.0 per cent of their total tax collections. This average was, however, pulled up by the figures for a few states, as Table 30 shows:

TABLE 30

RATIO OF STATE INCOME TAX COLLECTIONS TO TOTAL TAX COLLECTIONS, 1940

Percentage	Number of states
0.0– 4.9	4
5.0– 9.9	17
10.0–14.9	6
15.0–19.9	5
20.0–24.9	1
25.0–29.9	1
30.0–34.9	1
	35

New York and Massachusetts secured 33.0 per cent and 28.4 per cent of their tax collections from income tax, and Oregon, Maryland, and Wisconsin secured 18.9 per cent, 17.7 per cent and 21.2 per cent. Twenty-one states, however, secured less than 10.0 per cent. The same uneven development can be indicated in another way. Three states, New York, Massachusetts, and California, raised 53.7 per cent of total state income tax collections, and five states, New York, Massachusetts, California, Wisconsin, and Pennsylvania secured 70.6 per cent.

In 1940 state income tax collections were equal only to 17.4 per cent of federal tax collections and it is certain that the percentage will not again be as large for many years. Even in 1940 federal exemptions in taxation of personal income were lower than those in most of the states and the drop in federal exemptions in 1941 pushed them below those of all but a handful of small states. The scale of progression in state taxes is necessarily mild because of the steepness of that in the federal tax. With federal collections from taxation of corporation and personal income estimated for 1944 at $32,700,000,000, state collections have shrunk to 1.5 per cent of this figure.

Facts such as these raise pointedly the issue of transfer of income tax to federal jurisdiction. The states as a whole have

[70] *Federal, State and Local Fiscal Relations*, p. 347.

failed to utilize this source when they had the opportunity, and the present federal extension may mean that the opportunity has passed. With a few honorable exceptions state taxation of income has brought with it a plague of unfair practices and petty evils which have been tolerated only because tax levies were moderate. It cannot be doubted that the federal government, in sole possession of the tax, would raise a given amount of revenue more fairly and economically than this could be done with the present divided jurisdiction.

Can a *quid pro quo* be devised which would induce the states to give up their jurisdictional rights? The figures given above indicate that, in terms of present collections, the states would not be relinquishing a great deal; and in terms of future prospects it is hard to believe that income taxation will be very productive to the states as a whole. As always, however, the case differs enormously from state to state. Income taxation means a great deal to New York; it means little to the dozen or so states which make no levy. Yet in any national adjustment the latter group would have to be given compensation on the same principles as New York. *In lieu* payments would add larger amounts to the revenues of states now without income taxation, and unless special safeguards are devised this would be certain to have bad results. What might be suitable safeguards? Perhaps these states might agree to give up certain objectionable forms of taxation; perhaps they might agree to use the *in lieu* payments to retire debt. Or possibly the federal government, in place of making *in lieu* payments, might take over certain functions now resting upon the shoulders of the states.

The plain fact is that a tax transfer of the sort indicated ought to be part of a larger plan of federal–state fiscal readjustment. An *ad hoc* settlement with respect to income tax alone, even if it could be worked out, would leave unsettled many issues which, in essence, are closely related. An over-all settlement would, in principle, almost certainly be no more difficult than a partial settlement; and even if it were, the prize is worth the effort.

CHAPTER XIV

COMMODITY TAXATION

In the realm of constitutional law, courts are fond of professing that it is not they that speak, but the Constitution that speaketh in them. . . . Where the Constitution is not wholly mum, it often speaks with such a still, small voice that only a bare majority of the Court can hear its echo. Yet the judicial opinions seldom recognize the patent fact.

THOMAS REED POWELL.[1]

Wise tax policy is one thing; constitutional prohibition quite another. . . . It is not for us [the Supreme Court] to sit in judgment on attempts by the states to evolve fair tax policies. When a tax appropriately challenged before us is not found to be in plain violation of the constitution our task is ended.

JUSTICE FRANKFURTER.[2]

THE TARIFF as a form of commodity taxation was long the chief source of federal revenue. With the Civil War a great number of excises were added, together with some direct taxes, but gradually these were eliminated, leaving as a permanent part of the revenue system principally levies upon liquor and tobacco. As late as 1913 the tariff plus excises upon liquor and tobacco brought in 82 per cent of the federal tax revenue, and although from this time on there was greater diversification and especially a greater reliance on direct taxes, in 1934 over 60 per cent and in 1937 over over 42 per cent of the total was provided by consumption taxes.

Until recent decades the states attempted commodity taxation only on an insignificant scale. Then in 1919 the gasoline tax was initiated and it proved to be productive beyond all expectations. Encouraged by this success and also by the release from federal taxation of many commodities and services after 1920, a few states made timid experiments. But even apart from the many constitutional problems posed by the interstate commerce clause, they were held back by jurisdictional difficulties. The fear existed that taxation of sales might cause migration of business into a tax-free area. Economists were inclined to discount this possibility so

[1] "Indirect Encroachment on Federal Authority by the Taxing Authority of the States," 32 *Harvard Law Review* (June 1919), p. 930.

[2] *Newark Fire Insurance Co.* v. *State Board of Tax Appeals,* 307 U.S. 313, at 323–24.

long as tax rates were kept at a moderate level, and unquestionably a good deal of consumer buying is localized because of inertia, the small size of many purchases, personal relationships, etc. But some is not, and a retailer close to the boundary of a tax-free area may be tempted to move, if subjected to a sales tax, because his opportunity to shift his tax to his customers will be slight. And purchases of large items, such as refrigerators, radios, machinery, can be diverted interstate; groups of individuals can join together to secure interstate bargain prices and firms can grow up in a tax-free area to take advantage of the subsidy which a sales tax gives to interstate business.

The major constitutional problem about state sales taxes concerns interstate commerce.[3] There is, of course, no coincidence between the political boundaries of the states and the economic areas served even by retail outlets, and yet the states until recently were prohibited from taxing sales across their borders. The Supreme Court was zealous in barring taxation of all transactions which had an interstate character. Sales made by merchants to customers who were outside a taxing state could not be taxed, and sales made by merchants who were outside a taxing state to customers in it were likewise debarred.[4] The amount of consumer's expenditure which is interstate varies considerably in different states—one estimate is "from less than one to as much as eight percent."[5] and therefore the constitutional limitation made a great deal of difference. It is easy to argue that the national effect of this interpretation has been good: that in a federalism the natural and inevitable multiplication of jurisdictional barriers to an integrated nationalism required this sort of antidote or offset. One may argue further that sales taxation by states is, in any case, a fiscal perversion. Certain it is that the commerce clause did put obstacles in the way of the states. These obstacles were impressive and they held back any great spread of state taxation of commodities until the depression. Then taxation of tobacco products and, after repeal, taxation of liquor, spread from state to state.

[3] The commerce clause is no longer a serious obstacle to most other forms of taxation, e.g., of net income, of property, etc. Severance taxes and taxes on manufacturing, even when the products are exported, have now been held not to infringe the clause. It must be kept in mind that interstate movement of goods to wholesalers and manufacturers, which in volume is perhaps 90 per cent of the total, is not affected by a retail sales tax.

[4] N. H. Jacoby, *Retail Sales Taxation* (Chicago, 1938), pp. 140–44.

[5] *Ibid.*, p. 166.

Most important of all, the states began to adopt retail sales taxes at a pace which surprised most observers.[6] State legislatures were unimpressed by arguments against these taxes on grounds of equity and they were attracted by the certain prospects of substantial collections. Perhaps the clear indication by Congress that, despite a great extension of federal taxation of specific commodities, it did not propose to levy a federal sales tax, hastened entry of the states into a field which they might make their own. In 1931 six states had general sales taxes, bringing in a total revenue of about $4,000,000 most of which was raised in West Virginia and Mississippi; six years later twenty-four states had general sales taxes, bringing in a revenue of $431,000,000.[7] By 1942 the number of states had declined to twenty-three but the yield had increased to $629,000,000.[8] The only single source which had a larger yield was the gasoline tax, and it was levied by all jurisdictions. Table 31 shows for 1942 the percentage which sales and use tax revenues were of total state taxes[9]:

TABLE 31

SALES AND USE TAX REVENUES AS PERCENTAGE OF TOTAL TAX REVENUES, FOR SELECTED STATES IN 1942

State	Percentage	State	Percentage
West Virginia	45.8	New Mexico	26.0
Illinois	26.7	Colorado	23.5
Arizona	20.1	Utah	22.2
Ohio	21.4	North Dakota	22.5
Michigan	32.9	Wyoming	24.2
Washington	38.0	Arkansas	17.6
California	30.8	Mississippi	21.3
South Dakota	23.5	Oklahoma	17.5
Indiana	27.0	North Carolina	13.9
Kansas	26.5	Alabama	14.9
Iowa	26.4	Louisiana[a]	...
Missouri	27.8		

[a] The Louisiana sales tax was repealed in 1940 and reënacted on September 1, 1942.

[6] The cautious authors of "Double Taxation" said in 1932 (pp. 132–33): "While there has been some movement in the states toward a general sales tax, it appears that the majority of the states are still opposed to incorporating such a tax in their fiscal systems."

[7] U.S., Bureau of the Census, *Financial Statistics of States*, 1937. In addition, a considerable number of cities had general sales taxes. See also Jacoby, *Retail Sales Taxation*, p. 71. The number of states counted as having taxes depends on what is called a general sales tax.

[8] U.S., 78th Congress, 1st session, House Hearings before the Ways and Means Committee, Revenue Revision of 1943, p. 1230.

[9] *Ibid.*

The predominant type of tax used by the states (and cities) has been the retail sales tax. A manufacturers' sales tax as used notably by the federal government in Canada is administratively simpler,[10] since it allows collections to be made at fewer points, but it is not available for the states because manufacture and consumption within a state are not synonymous. Some states have few manufacturing concerns; others have many which ship across state lines. In both instances consumption within a state would not be tapped by a manufacturers' sales tax. But although state sales taxes are therefore similar in that they are usually on retail sales, or at least on some late stage in the productive process, they are quite dissimilar in their coverage. At one extreme is a retail sales tax with numerous exemptions according to the type of commodity, e.g., food as a necessity of life, or the type of buyer, e.g., educational and charitable institutions. At the other extreme is the so-called gross income tax which includes, besides sales of commodities, gross income from all sorts of services. In this latter group fall the taxes levied by Indiana, West Virginia, and perhaps three other states (Washington, New Mexico, and Mississippi). Fifteen states tax retail sales with a great variety of exemptions; two have a wider coverage—Arizona taxing sales to manufacturers and North Carolina sales to wholesalers, as well as sales to retailers.[11]

This extremely rapid growth focused the attention of tax authorities upon the constitutional and jurisdictional difficulties of state sales taxation. The opinion emerged that the Supreme Court had been too severe in the restrictions which it had placed upon state taxation of interstate commerce. Wittingly or unwittingly its decisions had served to favor interstate, as compared with intrastate trade; and it is hardly an exaggeration to say that their effect was to discriminate against intrastate trade rather than to debar discrimination against interstate. The question came to be asked: Would not constitutional principles be served if the states were prohibited from levying taxes which discriminated against interstate commerce? And since it was not at first the expectation that the Supreme Court would promptly alter the tenor of its decisions, a movement grew up which aimed at securing Congres-

[10] In wartime, after a system of price and wage control has been established, this generalization does not apply.

[11] See Jacoby, *Retail Sales Taxation,* chapter v, also pp. 10–18.

sional permission for the states to levy nondiscriminating taxes on sales in interstate commerce, with payment to be made by retailers to the state into which the commodity came.[12] Some authorities denied, while others affirmed, that Congress had the constitutional power to delegate this right.[13] And, wholly apart from the constitutional issue, opposition to this scheme was strong, because of the widespread conviction that a strict interpretation of the commerce clause is in the national interest, and because state taxes on interstate commerce, even when so framed as to be nondiscriminatory in form, might be discriminatory in administration. The courts have been very unwilling to admit the existence of administrative discrimination and they have, moreover, accepted as reasonable many types of tax classification which, to the eyes of an economist, seemed aimed at securing special advantages for a state. In the face of these uncertainties Congress chose not to legislate, and meanwhile the states discovered another possible remedy in the form of a use tax.

The Use Tax

The use tax in practice is a levy upon commodities purchased outside a state, but brought into it for use. Supplementary to the sales tax, its rates, application, etc., are generally identical.[14] As state sales taxes grew in number the differential created by the current constitutional doctrine in favor of interstate sales naturally grew, and this was irksome both to tax administrators and to merchants in sales tax states, since the former faced a threat to revenue and the latter a loss of business to out-of-state competitors. The lenient attitude of the courts toward use taxes on gasoline and tobacco encouraged the hope that a *general* use tax might surmount the constitutional hurdle, and this proved to be so. In

[12] See U.S., 73rd Congress, 1st session, House Hearing before a Subcommittee on Interstate and Foreign Commerce, State Taxation of Goods Shipped in Interstate Commerce.

[13] See Lowndes, "State Taxation of Interstate Sales," *Proceedings of the National Tax Association,* 1934, pp. 139–48; Rottschaefer, *ibid.,* pp. 149–55; Perkins, "The Sale Tax and Transactions in Interstate Commerce," 12 *North Carolina Law Review* 99.

[14] In 1940 seventeen states had separate use taxes; forty-five had gasoline use taxes, seven had tobacco use taxes, and others had use taxes of less importance. It should be pointed out that, in principle, the use tax may apply to all commodities purchased intrastate as well as interstate. In practice, however, the use tax has reached only commodities purchased interstate.

1937 the Supreme Court upheld a Washington use tax as not upon interstate commerce, but upon the privilege of use after commerce had ended.[15] And the tax was declared not to impose a discriminatory burden; on the contrary, it served to place "retail dealers in Washington . . . upon terms of equality with retail dealers in other states who are exempt from a sales tax or any corresponding burden."

This relief from constitutional impediments did not, of course, free the use tax from other difficulties. If a state sales tax is administratively awkward because it has to be applied to a large number of sellers, obviously a use tax is still more awkward since it is applicable to a much greater number of users of commodities. The states have faced this in various ways. Some let out a lot of people by exempting a specified amount of property. Thus one tax official has stated:

> We have solved the principal difficulty which inheres in use tax administration by the simple expedient of exempting from the tax those from whom its collection would be most difficult—the customers of local merchants. And while this solution is not one of which the tax administrator can be very proud, the question might well be asked: Who could be proud of a use tax anyway? It was conceived as an expedient in the first instance. It does not stand on its own merits, but is merely a satellite of the sales tax and its continued existence is dependent upon the continuation of the sales tax in its present form.[16]

In some cases, even without an exception, enforcement is limited to purchases of high value per unit. But it should be observed that businesses which have outlets in a taxing state may agree to collect the use tax on *all* their sales to consumers there in order to avoid trouble, and that some, e.g., mail order houses, may similarly agree, even though they have no outlets, as a matter of business policy.[17] In any case, it must be remembered that the chief

[15] *Henneford et al.* v. *Silas Mason Co.*, 300 U.S. 577. See *Tax Policy*, March 1940, for a convenient summary of earlier and later cases. Also Maurice Criz, *The Use Tax* (Public Administration Service, Chicago, 1941), chapter iv.

[16] L. D. Melton, "Administration of the Use Tax in Oklahoma," *Proceedings of the National Tax Association*, 1939, pp. 258–59.

[17] In *Nelson* v. *Sears Roebuck & Co.*, 312 U.S. 359, and *Nelson* v. *Montgomery Ward & Co.*, 312 U.S. 373, the Supreme Court upheld the right of Iowa to require mail-order houses to collect a use tax on their purely mail-order business (Hughes and Roberts dissenting). The state obviously could not collect the tax from its own citizens, and the companies argued that they could collect only a portion (60–80 per cent). But the Court declared that a business firm could not found a constitutional right "on the practical opportunities for tax avoidance which its method of business affords Iowa residents." *Ibid.*, at 366.

purpose of the use tax is not to raise a revenue, but to prevent a loss of sales tax revenue.[18] The use tax clearly raises new possibilities of multiple taxation and of discrimination against interstate purchases. If two states, X and Y, have both sales and use taxes, a buyer in one who makes a purchase in the other will pay both a sales tax and a use tax, while if he buys only intrastate he will pay only a sales tax. In such case interstate trade bears a special burden. A remedy is at hand and it has been used by ten of the seventeen states with a use tax: this is to grant a deduction equal to the amount of the sales tax paid in the outside state against the use tax assessment in the home state. But when this is not done, the use tax operates as the equivalent of a state tariff.[19] So far few instances of multiple sales and use taxation have occurred, but manifest possibilities are present and one cannot but be pessimistic about the prospects that the states will exercise forbearance.[20]

The sanction which the Supreme Court gave the use tax has led, by a process of thought which is clear after the event, to a broadening of the constitutional basis of sales taxes. In 1940, by the Berwind-White decision,[21] the Court upheld the tax which New York City imposed on sales of coal to its residents delivered by a Pennsylvania vendor. In logic the earlier approval of a use tax on goods sold in interstate commerce implied approval of a sales tax on goods sold similarly; and a state with a use tax as a complement to its sales tax did not need the new decision in order to be able to impose a use tax on the type of transactions now made subject to a sales tax. The decision, by widening the applicability of the sales tax, narrowed the significance of the use tax.

[18] In 1939 use-tax revenues "formed only one-fourth of 1 per cent of total state revenues, and four-fifths of 1 per cent of the total taxes of the 12 states reporting use-tax revenues in that year." Criz, *The Use Tax*, p. 36.

[19] If the article against which a use tax is levied is not purchasable in the home state, the effect is to put a direct burden on interstate commerce.

[20] Professor Jacoby (*Retail Sales Taxation*, p. 115) notices that the Ohio law has a provision which seems designed to encourage exports. A nonresident may buy goods in the state free of tax, if they are to be used outside the state.

[21] *McGoldrich* v. *Berwind-White Coal Mining Co.*, 309 U.S. 33. There were three companion decisions.

Present Situation: Its Difficulties and the Remedies Proposed

What is now certain is that interstate commerce will no longer enjoy a subsidy over intrastate. Whatever was the case in the past, in the future interstate commerce will bear its share of state–local taxation. The danger is that it will be forced to carry more than its share. Possibly the Supreme Court, while sanctioning nondiscriminatory, will condemn efforts to impose discriminatory levies on interstate commerce, although evidence exists that a majority of the Court does not believe this to be its proper function. Yet if the courts do not restrain the particularism of the state, multiple tax burdens on interstate commerce are likely to swell.[22]

And in addition to evils of this sort, state sales taxes pile up duplicate administrative and heavy compliance costs. The taxes differ in scope, in rates, in definitions, in exemptions, and in administrative procedure. These are difficulties manufactured by careless draftsmanship, by attempts to gain some state advantage, and by perverse manifestations of state individuality. A longer experience, extension of coöperation, and application of reciprocal provisions may reduce some of these difficulties, but there is little in the history of state taxation which encourages one to be hopeful.

Various types of federal intervention have been suggested as remedies. One proposal is federal collection of a sales tax with distribution to the states.[23] This would, of course, remove jurisdictional conflicts and duplicate administration, and it would reduce compliance costs.[24] Here, as in all similar proposals, the

22 T. R. Powell, "The Current Current of the Commerce Clause and State Taxation," *Proceedings of the National Tax Association,* 1940, p. 313. Since the emergency, numerous disputes have arisen concerning the applicability of state sales taxes to war contracts and to sales at post exchanges. By the Buck act, which removed the territorial immunity of transactions taking place on federal reservations, Congress indicated its willingness to give the states considerable freedom to tax. The army and navy have, however, objected to many of the state levies. At present the position is obscure, but some disposition to give a broad immunity to war contracts has appeared.

23 For administrative reasons, such a federal levy if imposed after the war might well be a manufacturers' sales tax.

24 It would also remove the problems which arise because of state inability to tax sales made to the federal government and sales consummated on federal territory. The Supreme Court by recent decisions, particularly in the case of *James* v.

states would be yielding an authority to the federal government and placing themselves somewhat within federal control, and unflinching advocates of states rights would line up in opposition. Another and very different ground for opposition would be presented by those people who regard general sales taxes as fiscal perversions. A few years ago they could and did argue that the plague of state taxes which had appeared with the depression was a transient phenomenon; and many early laws justified this hope by naming a date for their expiration. In almost every case, however, the expiration clause has been deleted or extended in time and few people would now venture to prophesy that sales taxes will soon be dropped as a major source of state revenue. But even if this admission be made, the opponents of general sales taxation can point out that a number of states are not in the field and that a scheme of federal collection would, in effect, force upon them a system of regressive taxation which their own citizens had not endorsed. It is by no means clear that the sales tax is a desirable source of revenue even for some of the states which now utilize it, and yet federal collection and distribution would effectively block any attempts at repeal.

Any scheme of shared taxes raises also a debate about the proper basis of distribution. The assumption of many proponents that distribution should be on the basis of origin of the sales is quite unrealistic. Collections from a manufacturers' sales tax, which is the type most suitable for postwar federal use, do not correspond from state to state with those of a retail sales tax. Manufacturing is concentrated in a few states and in them collections would be heavy; distribution according to collections would, therefore, be quite unjustifiable for a tax which bears directly on consumption. It would, however, be possible to make the distribution according to retail sales in each state even though the levy is not made on retail sales, since figures of this sort are available, prepared by the Bureau of the Census.

Assuming that this would be fair, let us examine what would be

Dravo Contracting Co., 302 U.S. 134, has widened the scope of state taxes, but many limitations remain. And the attempt of Congress by passage of the Buck act in 1940 to reduce the immunity of transactions taking place on federal reservations (other than those made by a federal instrumentality) has so far produced few good results.

the outcome.[25] The most immediate difficulty arises out of the fact that, while all the states would be allotted a share of the federal collection, some do and some do not now receive a revenue from a sales tax. The sales tax states would receive a revenue from the federal treasury as an approximate substitute for their own tax; the others would receive a windfall addition to their existing tax revenues (depending upon the rate of the federal levy), and such an accretion might well lead to wasteful spending. In every state there are, to be sure, functions on which more could be spent justifiably and without extravagance, and in time these might be found. The problem would be to prevent dislocation and waste in the short run.[26] But even if this difficulty were overcome, there is another inherent in this and any other scheme of tax-sharing which does not veer toward some "equalizing" basis of distribution. Poor states are poor in the collections of a consumption tax to which they would be entitled. The Interstate Commission on Conflicting Taxation, working with reasonable premises, found that Mississippi with a population 35 per cent of that of New York would secure a revenue share of a federally-collected sales tax which was only 8 per cent of the New York share. Alabama, with 21 per cent of the population of New York, would get only 7 per cent as much of a revenue share.[27] Thus the scheme would not remove and it might even aggravate the existing disparity in state fiscal positions.

For this reason there have been suggestions that distribution be made upon some other basis of which the most obvious is population. The rich states would then receive smaller, and the poor states larger shares than those to which they would be entitled if allocation were measured by the consumption of their own citi-

[25] The proposal has been examined carefully by the Interstate Commission on Conflicting Taxation and what follows is based upon this study. See the 1935 progress report of the commission: *Conflicting Taxation* (Council of State Governments, Chicago, 1935), pp. 72–87.

[26] It is easy to think of ways to bridge this difficulty, if the federal government were prepared to attach conditions to its tax-sharing. Suppose for example that any net addition to the revenue of a state as a result of the scheme was required, for some interim period, to be used for purposes of debt retirement, with a gradual relaxation of this condition in later years.

[27] *Conflicting Taxation,* p. 80. The figures were based upon population in 1930, retail sales reported in 1933, and a federal manufacturers' sales tax of 4 per cent of which 2.5 per cent is shared with the states and 1.5 per cent is retained. More recent figures and different assumptions would not alter important facts brought out in the illustration above.

zens. Interstate transfers of revenue would occur, and if we suppose that no strings are attached by the federal government to its allocation, tax-sharing would become a sort of unconditional grant.

The obvious difficulties of the federally-collected state-shared scheme force consideration of a more limited form of federal intervention. Congress might pass a law authorizing nondiscriminatory state taxation of sales in interstate commerce. Some years ago, when this proposal was advanced, it met with objections from those who wished to retain a strict interpretation of the commerce clause. At present, however, this interpretation has gone, and the new attitude of the Supreme Court makes intervention so much the more necessary. Some members of the Court, while insisting upon judicial abrogation, have declared that Congress has the right and the duty to act. For example Justices Black, Frankfurter, and Douglas recently said:

> Spasmodic and unrelated instances of litigation cannot afford an adequate basis for the creation of integrated national rules which alone can afford that full protection for interstate commerce intended by the Constitution. . . . Unconfined by the narrow scope of judicial proceedings Congress alone can . . . on the basis of full exploration of many aspects of a complicated problem, devise a national policy fair alike to the states and to our Union. Diverse and interesting state laws may well have created avoidable hardships. . . . But the remedy, if any is called for, we think is within the ample reach of Congress.[28]

Here is a challenge to the Congress to act, and it should be taken up. Assuming that conflicting taxation is not to be solved by federal entry into the field of general sales taxation, Congress should be prepared to frame a set of conditions within which the states will be permitted to legislate. The purpose of such a statute would be to facilitate more effective state utilization of the sales tax, and one of the first effects would be to eliminate use taxes and the discriminations which are associated with them. The nation cannot tolerate the trade barriers which otherwise seem certain to develop.

Gasoline Tax

Before the war, taxation of gasoline brought a larger total revenue to governments in the United States than that of any other

[28] *McCarroll* v. *Dixie Greyhound Lines,* 309 U.S. 175 at 186–89.

TABLE 32

REVENUE FROM TAXATION OF GASOLINE, ALCOHOLIC BEVERAGES, AND TOBACCO, 1939[a]

	Federal	State	Local	Total
		(millions of dollars)		
Gasoline	$207.0	$800.1	$4.4	$1,011.5
Alcoholic beverages	587.5	212.1	3.3	803.0
Tobacco	597.9	58.0	5.1	642.9

[a] Tax Research Foundation, *Tax Systems* (8th ed., Chicago, 1940), p. 314.

commodity. Tobacco products and liquor, traditionally the favorite objects of levies, were more important to the federal government, but to the states the gasoline tax was more productive than any other source. In 1939–40 it produced over one-quarter of state tax collections and was nearly twice as important as the next most important class of state taxes.

The gasoline tax is relatively a parvenu. Suggested in 1915 as a source of federal revenue, it was not adopted until in 1919 Oregon and three other states levied a low-rate tax. Before ten years had passed every state followed and the level of rates had risen appreciably. But it took the depression to bring out the amazing elasticity of the tax. At a time when other sources seemed to be drying up, state revenue from gasoline tax (more accurately taxation of motor fuel) mounted steadily because of increased consumption and higher rates.

It is, then, little wonder that the states protested vigorously when, in 1932, the federal government entered the field as a competitor by levying a tax of one cent per gallon. This first tax was adopted only for one year, but the time has always been extended, and in 1940 the rate was raised to 1½ cents per gallon.[29] In the past the states had often complained of federal trespass and these complaints had not rung true. But this time it was different. The states had made vigorous use of the gasoline tax, and although their administration of it had faults, no such criticism could be made as might fairly be directed against income and death taxation, or against most state taxation of other commodities. Moreover, the principle upon which the gasoline tax has been defended most often in the United States is benefit, and this principle makes more sense when applied to state than to national taxation.

[29] The rate also was 1½ cents June–December, 1933.

The federal government began to give grants to the states for public roads in 1916, in order to stimulate state expenditure and to indicate the national interest in improved roads, and after 1931 federal expenditure was greatly expanded in an effort to assist recovery. But these aims did not warrant financing the expenditure on the benefit principle. States will not be eager to receive grants for highways if the money is to come from a federal gasoline tax; the national interest in improved highways stems from a concern in the general welfare, and any individual or group benefits which accrue are incidental. A federal gasoline tax, moreover, bears directly on consumption, and it was wholly inappropriate as a means of financing recovery.[30] The fact is that Congress in 1932, looking for methods of raising more federal revenue, was not overconcerned with intergovernmental comity. The limitation set to the period of the gasoline tax in each revenue act, and repeated affirmations about its temporary nature indicate at the most only mild Congressional compunction. Yet in 1932–33 the fiscal need of the states was more acute than that of the federal government, and the gasoline tax was a levy which could be handled by the states and which, on grounds of distributive justice, added nothing to the federal tax system. The repeated requests made by the states (through the Council of State Governments and the Interstate Commission on Conflicting Taxation) for federal withdrawal might well have been heeded.

It must not, however, be thought that state taxation of gasoline raises no problems and brings no jurisdictional conflicts. The constitutional questions have, indeed, never been very troublesome, because the courts, after some preliminary hesitation, placed few obstacles in the way of taxation of motor fuel. Difficulties of interstate commerce still remain, but the notion of applying the tax to the use, as well as the sale, was first developed in connection with gasoline taxation, and its success led to extension in the form of a general use tax.[31] Attempts to apply the gasoline tax to sales of federal agencies and to sales on federal reservations have been less successful. The weakening of intergovernmental im-

[30] The federal government also taxes lubricants, tires, accessories, etc., but none of these can be actually associated with the user of highways. See *Facing the Tax Problem* (New York, 1937), pp. 554–55.

[31] See F. G. Crawford, *Motor Fuel Taxation in the United States* (Syracuse, 1939), chapter xiv, for a resumé of the leading cases.

munities through court decisions and voluntary permission by the federal government to imposition of state levies may remove these loopholes.[32]

Although constitutional difficulties have been slight, the rapid increase in rates after 1930—and particularly the uneven increase from state to state—made evasion a profitable business. Smuggling of gasoline across state borders is the obvious type of evasion, and while interstate coöperation in securing information about shipments has been used successfully to check large-scale leakages of this sort, it cannot prevent petty smuggling. Tank trucks and tank steamers are mobile; false declarations, misbilling, and shipments to fictitious consignees are hard to detect. In spite of the cordial coöperation of the oil industry, which has been of great assistance to law enforcement, many states have been driven to such extreme measures as establishment of ports of entry in an attempt to check upon the shipment of gasoline in and out. Border police and highway patrols, usually with other duties, are related methods of enforcement. The high tax rates also have encouraged the growth of fly-by-night concerns selling gasoline. These concerns may collect the tax from purchasers, but they will not pay it to the state. Judgments secured against them are futile since the firms will have gone out of business or will have no assets. States have combated this sort of evasion by licensing distributors and requiring them to post bonds, and, when properly handled, this is adequate.[33] But some states are unduly severe and some are unduly lax, with injury to legitimate dealers. In Arkansas a surprising concession was made to interstate problems. Surrounded by states which imposed lower

[32] By the Hayden-Cartwright act of 1936 Congress authorized payment of state gasoline taxes on gasoline sold on federal reservations, when this fuel was not for the exclusive use of the United States. The Buck act, passed in 1940, went further and declared that the states could levy and collect taxes on income, sales, and use in federal areas. So far the act has raised many perplexities as to what is a federal instrumentality. See J. M. Mesnig, "The Buck Resolution," *Proceedings of the National Tax Association,* 1941, pp. 150–55.

[33] In Ohio the average yearly loss from delinquencies, 1925–1931, was $400,000, but after provision of a bonding requirement it nearly disappeared. Crawford, *Motor Fuel Taxation,* p. 37. High rates have also encouraged blending—mixing of gasoline with other fuels. Broadening of the definition of motor fuel is one method to check this sort of evasion, but there is no possibility of complete agreement here, and a very broad definition extends taxation to petroleum products which cannot conveniently be taxed. (Northeastern States Tax Conference, Motor Fuel Section, December 6, 1934, New York, mimeographed, pp. 7–9.)

gasoline taxes—Missouri with a rate of 2 cents, Oklahoma and Texas with rates of 4 cents—it declared that in border cities the rate imposed by the neighboring state, rather than its own rate of 6½ cents, may be collected.[34]

The states have unfortunately multiplied the opportunity for evasion by putting exemption and refund provisions in their laws. If the gasoline tax is held to be a levy for use of the public highways for the operation of motor vehicles, it follows that those people who use gasoline for other purposes, e.g., in tractors, motorboats, aircraft, stationary engines, etc., should be exempted or should receive a refund. There is, however, no sound reason why the benefit principle should be pressed so far and construed so strictly, and those states which give no refunds or exemptions save themselves a great deal of administrative difficulty. The figures for Kansas show that its exemptions grew from 57,751,000 gallons in 1930 to 127,270,000 gallons in 1937.[35] Sometimes the exemptions and refunds are the consequence of a literal and unjustifiable application of the benefit principle; sometimes they represent a straining after fairness which, in practice, introduces serious inequities; sometimes they are concessions to influential groups, such as farmers, who use motor fuel off the highways. The evidence is conclusive that refunds and exemptions open the door to evasion, complicate and increase the cost of administration, and therefore reduce the yield which the tax ought to produce.

With the depression in 1930 all the states, through more carefully drawn statutes, stricter penalties, tighter enforcement, and coöperative exchange of information, attempted to strengthen their taxation of gasoline. For some of these efforts there can be nothing but praise, and if the states could coöperate to solve their common problems, many of the evils of conflicting taxation would disappear. Not infrequently, however, the efforts by individual states serve to aggravate the conflicts and to increase the stresses of federalism. State ports-of-entry and border patrols

[34] Crawford, p. 109.

[35] From 15.9 per cent to 27.6 per cent of gross sales (Crawford, p. 45). In 1940 the tax-free figure grew to 31.1 per cent. Other states with high tax-free percentages in 1940 were North Dakota 41.7 per cent, Montana 24.1 per cent, South Dakota 22.0 per cent, Colorado 17.9 per cent (U.S., 77th Congress, 2nd session, House Hearings, Ways and Means Committee, Revenue Revision of 1942, p. 2631). In general the refund system is tighter in its administration than the exemption system.

may operate as state tariffs; expanded enforcement agencies may mean greater compliance costs and higher absolute costs of collection. Some critics are convinced that the states, left to themselves, will never find a remedy, and that, on the contrary, the situation is bound to become worse. Thus here again the issue of federal intervention is raised.

FEDERAL COLLECTION AND STATE SHARING

The scheme discussed most frequently has been federal collection with distribution to the states,[36] and it encounters difficulties which are already familiar to readers of these pages. What is to be the basis of distribution? Population, motor registration, mileage of improved roads, motor fuel consumption—and perhaps others—have been proposed; and since any one of these, or any combination, will seem to favor some states over others, agreement must depend upon federal coercion. The "fairest" plan that the mind of man could devise would not, moreover, remove the practical difficulty which arises from the fact that all the states must be treated alike when they are not alike in their present dependence upon taxation of motor fuel.[37]

Real doubt must, therefore, be expressed concerning the feasibility or the desirability of solution along these lines. Here is a tax which the states can administer and which they do administer with fair success. Why, then, should it not be left in their hands? For the duration of the war federal withdrawal was out of the question, but at some future time—perhaps as part of a general overhauling of federal–state fiscal relations—withdrawal appears to offer a net advantage. If this should come to pass, it would not be unreasonable, as a condition of federal withdrawal, to require modification of state tax practices so as to remove abuses which now exist. Possibly the states could be brought to a uniform definition of motor fuel and of licensed distributors, and possibly the federal government might assist the states to secure and utilize more complete figures of interstate shipments of petroleum products.

[36] The so-called Graves-Edmunds plan, which contemplates federal collection and sharing of taxes on gasoline, liquor, cigarettes, and a manufacturers' excise, has frequently been discussed at meetings of the National Tax Association (see *Proceedings*, 1936, pp. 166–69).

[37] For a fuller discussion of schemes for elimination of conflicting taxation in the motor fuel field see *Federal, State and Local Government Fiscal Relations* (78th Congress, 1st session, Senate Document No. 69), pp. 523–27.

Tobacco Taxes

During the Civil War tobacco taxes, for the first time, came to occupy an important place in the revenue system of the federal government, and in the years afterwards they were retained although at reduced rates. With the Spanish-American war the federal taxes on tobacco were temporarily doubled (until 1902). By 1910 they brought $58,100,000 into the federal treasury—9.3 per cent of total taxes. With the preparedness program and then World War I the rates of the tobacco taxes were sharply raised. By 1919 the yield was $206,000,000, and because of the amazing spread in the use of cigarettes Congress found in them an unusually productive source of revenue. In the 1920's each year saw larger yields. By 1928 the federal tobacco revenue was $396,500,000 of which $301,800,000—over 76 per cent—came from cigarettes.[38]

By this time the states had slowly begun to enter the field, Iowa making a beginning in 1921 by levying a tax on cigarettes and cigarette papers. By 1930 eleven states were taxing tobacco products, sometimes as part of a system which covered other luxury articles as well. To these taxes there was at first considerable opposition, especially from dealers, who protested that the handling of the stamps which had to be affixed to the products was time-consuming and expensive. It took time, moreover, to work out proper methods of collection and administration. The tobacco manufacturer was not ordinarily located in the state which levied the taxes, and most states soon decided that those dealers making the first sale within their boundaries were the most convient persons from whom to collect, particularly if collection was made by stamps.[39] Before the depression it seemed that in a relatively small number of states taxation of tobacco products was well established and could be expected to bring a modest revenue. The eleven states using the taxes collected about $10,800,000 in 1930—5 per cent of their total tax collections. There was, however, no expectation that this sort of taxation would be

[38] In 1915 cigarettes were responsible for 26 per cent of the tobacco revenue, while cigars were responsible for a slightly larger percentage. The federal rate on cigarettes, 1919–1932, was $3.00 per thousand, which meant a six-cent tax on a package of twenty.

[39] At first paper stamps were used, but these came off easily and they might also be deliberately removed and used again. Use of decalcomania stamps was a remedy.

widely adopted because the yield did not seem very attractive, because the costs of collection were high, and because the difficulty of checking evasion was great. This expectation was a mistake. By 1940, under the stimulus of depression, no less than twenty-eight states were in the field with collections of $97,789,400, and in eleven states tobacco taxes provided over 6 per cent of their tax revenue.[40] The anticipated difficulties had not been illusory, since many loopholes opened by interstate commerce had appeared and were causing the tax officials of the states a great deal of concern. But new and unusual methods of collection were being devised and it had become clear that the states had every intention of consolidating their position.

The first attempts of the states to tax tobacco products had been too insignificant to arouse either comment or concern at Washington. After 1930, however, when the number of states with these taxes grew rapidly and when also the federal government began to search for new sources of revenue, Washington began to talk of state trespass and to warn that this might persuade the federal government to retaliate. Thus Mr. Mills, the Secretary of the Treasury, when asked at a House Hearing in January 1932 on revenue revision why the federal government did not tax gasoline declared that in his opinion the states had a special claim to this source. Then he added:

> I want to say this, however, that if the states continue to trespass on what have always been regarded as taxes that belonged particularly to the Federal Government, the tobacco taxes—if the states continue, and they are doing it to an increasing degree, to impose tobacco taxes, then I say unhesitatingly we are justified in trespassing on States taxes and levying a gasoline tax. I think there ought to be amity between State and Federal Governments.[41]

Congress, despite the compunctions of the Secretary, actually levied a federal tax of one cent per gallon on gasoline in 1932, and in the next year a decline in the federal revenue from cigarettes persuaded some members of Congress that part of the explanation lay in the tax competition of the states. Mr. Doughton, chairman of the Ways and Means Committee, proposed that the federal government distribute to the states, according to their population, one-sixth of the revenue it derived from cigarettes, provided that

[40] A convenient summary of state collections and of the rates imposed can be found in *Tax Policy*, November 1941.

[41] U.S., 72nd Congress, 1st session, House Hearings before the Ways and Means Committee, Revenue Revision, 1932, p. 22.

each state refrained from taxing cigarettes and cigarette dealers. At the time nothing was done, but it will be worth while to consider the merits of this and similar suggestions after the administrative problems of the states, particularly in handling evasion, have been examined in more detail.

STATE ADMINISTRATIVE DIFFICULTIES

The states, when they entered the field of tobacco taxation, encountered administrative difficulties which the federal government never had to face. The federal government collects the taxes from the relatively small number of manufacturers of tobacco products, whereas the states must collect from the wholesalers and jobbers lying within their jurisdiction. "The State of New York alone deals with almost ten times as many taxpayers in collecting its cigarette tax as does the Bureau of Internal Revenue in collecting the federal cigarette tax."[42] This fact makes state administration relatively inefficient, difficult, and costly both in dollar costs and in terms of compliance. Organized and unorganized evasion poses problems which the states have been unable to solve.

Unorganized evasion has come to the attention of every citizen. The resident of a state which has a tobacco tax will often, if he has occasion to be in a state with no tax, make small purchases for the purpose of evading the tax. Individuals such as commercial travelers or truck drivers, who pass frequently across state boundaries, may as a side line smuggle tobacco products and sell them direct to consumers or dealers. Against this sort of petty evasion a state, when armed with a use tax,[43] can resort to stricter enforcement and to bluff. For example, in Arkansas minor violations have been

> discovered and apprehended through secret service men and the departments' raiding squad. The secret service men sometimes go about their duties in overalls, sometimes as well-dressed college men. They buy cigarettes and after they have worked themselves into the proper situations, they undertake to get the cigarettes and liquor on which the tax has not been paid. . . .[44]

[42] *Federal, State and Local Government Fiscal Relations*, p. 500.

[43] By 1939, seven of the states with a tax on sales had neglected to enforce a use tax as an accompaniment, thereby making difficult their defense against interstate sales.

[44] *Proceedings of the National Tobacco Tax Conference*, 1936, p. 8, speech by N. E. Sheffield, supervisor of the cigarette tax division, Department of Revenues,

Another type of unorganized evasion which is irritating to state officers arises out of sales on federal property.

> The high point in the use of a federal instrumentality to evade [cigarette] taxes is the use of the Texarkana post office which is situated between Arkansas and Texas. Cigarette shipments coming in the front door may leave through the back door, thus passing over a state line untaxed without even having left the building.[45]

A more extensive problem arises from sales on federal reservations. In a state like Arizona, which has been described "as a mass of federal islands each occupied by either Indian reservations, military reservations, national parks or veterans hospital facilities,"[46] this is a genuine difficulty, but neither in Arizona nor in other states have attempts at collection been successful.

Organized evasion offers a still more serious threat to the state revenues. In most cases an attempt has been made to collect the tax on the first sale (or use) in a state. If all cigarettes (or tobacco) come in through wholesalers or jobbers who are located in the state and who serve as distributors for the retailers, then the task of collection is eased since it is unnecessary to police the thousands of retail outlets. Some states, e.g., Arkansas, force this process by forbidding retailers to receive drop shipments and by requiring that all cigarettes be first received by a licensed jobber who pays the tax before selling the product to retailers in the state. But even this will not affect out-of-state wholesalers who make sales directly to consumers in the taxing state. These consumers are, of course, subject to the use tax and some states have attempted to apply it. But it is nearly impossible to locate the tobacco products subject to the tax and therefore this device will not work. The states can also require common carriers to report in detail all cigarettes shipped. But again the cigarette bootlegger can dodge by making shipments through the mail by parcel post. The states can also exchange information with each other concerning interstate shipments, and at least eight states appear to be doing so at present. In the taxation of gasoline this had

Arkansas. The severity of the penalties in a state law occasionally attract the attention of the press, and so also do the threats uttered by state revenue officers in an effort to frighten casual smugglers.

[45] T. F. McCanless, "Taxing Sales on Federal Reservations," *Proceedings of the National Tobacco Tax Conference,* 1939, p. 1.

[46] *Ibid.,* also p. 19. Half the state is taken up with federal reservations. Congress passed an act on October 9, 1940 (Public 819), giving authority to the states to levy sales and use taxes on articles sold and used on federal reservations.

done much to check evasion and doubtless it has not yet been fully exploited. But with respect to cigarettes there are clear defects to its application. Since cigarettes can be shipped by mail, as gasoline cannot, dealers who wish to evade the tax can make shipments which they will not report. A still larger loophole is opened by the fact that no reports are received from states which do not have tobacco taxes. These states naturally have no interest in coöperating and, since the number of them is now and will continue to be considerable, jobbers who are located within their boundaries can feel safe.

That these jobbers are active has doubtless come to the attention of most people who live in tobacco tax states. A tax official of South Carolina has described how in 1937 these out-of-state dealers carried on in his state an extensive campaign during which postcards advertising tax-free cigarettes were addressed to the license tax division of the Tax Commission itself.[47] In this advertising the prospective customers are informed that they need not fear detection or punishment. The law enforcement officers have struck back, but without much effect, and the business of evasion is still prospering. State administrators of tobacco taxes have estimated that about 20 per cent of taxable sales escaped in 1938.[48] Tighter administration and better interchange of information by uniform reports will doubtless cut down some of the tax losses, but most state officials at present desire to enlist the assistance of the federal government.

If federal legislation were passed which gave the states access to post office records, it is clear that an important type of evasion could be checked, and several bills for this purpose have been brought before Congress. In 1937 the Tax Commissioner of Georgia appealed to President Roosevelt, and the President in his reply, while pointing out the dangers and difficulties of interference with the mails, stated that he was not opposed "to federal legislation so restricted as not to open the doors to abuse. . . . "[49]

[47] *Proceedings of the National Tobacco Tax Conference*, 1939, p. 29. That, according to the official, was "the last straw."

[48] *Ibid.*, p. 3. This means $10,000,000 out of total collections of $50,000,000. Some of the losses of particular states were: Texas $750,000, Iowa $1,000,000, Oklahoma $300,000, Arkansas $300,000, South Carolina $200,000, Mississippi $225,000, Georgia $300,000.

[49] *Proceedings of the National Tobacco Tax Conference:* 1937, pp. 34–36; 1939, pp. 5–7. See also U.S., 76th Congress, 1st session, House Hearing on H.R. 3835

But so far legislation has not been secured. The Post Office looks with disfavor upon the scheme because it fears that the federal government will become involved in policing tax legislation in which there is no federal interest and which concerns only a portion of the states. This opposition appears to be sound, and the argument sometimes advanced, following the precedent of liquor legislation, that interstate shipments of tobacco products in violation of state law should be prohibited, has no force. The tobacco taxes of the states are revenue and not social measures, and they are, besides, revenue measures which raise inherent administrative difficulties so acute that state relinquishment seems desirable if any thorough-going revision of federal–state fiscal relations is ever made.

FEDERAL COLLECTION AND STATE SHARING

The proposal that the federal government should allocate to the states some share of its revenue from taxation of tobacco products (or more particularly cigarettes), on condition that the states withdraw from this field, has often been advanced. The most obvious theoretical base for apportionment is state consumption, but no satisfactory figures are available. The federal government makes its collections from manufacturers, and this method, while undoubtedly efficient, gives no information concerning consumption in the various states. Distribution according to consumption would, moreover, face objection from the poorer and less industrialized states in which consumption of cigarettes—by far the principal source of revenue—is relatively low.

For these reasons most proposals have based apportionment upon state population. One such scheme, proposing that one-sixth of federal collections on cigarettes be assigned to the states according to population, was examined in 1935 by the Interstate Committee on Conflicting Taxation,[50] and although the situation has changed in many important details since then, this analysis serves to illustrate the principal problems. Obviously if all the states are to receive a share, those not levying the tax would receive a windfall gain in revenue. Those which are levying the

before the Committee on the Post Office and Post Roads, Cigarette tax bill; *Tobacco Tax Evasion through Interstate Parcel Post Shipments,* Research Report No. 6, Federation of Tax Administrators (Chicago).

[50] *Conflicting Taxation,* pp. 187–94.

tax might or might not secure more from the federal allocation than their own collections, depending upon the comparative productivity of their tax. A state with a high yield, whether because of high rates or large consumption, would be unwilling to accept less. Yet if the federal government should raise its distribution high enough to meet the demand of such a state, it would be giving a windfall revenue not only to states with no tax, but to states with small collections.

Distribution according to population would undoubtedly meet with opposition from the industrial and richer states in which consumption of cigarettes is high, and a modified basis for apportionment has therefore been suggested by which urban population is given a weight of 1.5 and rural population a weight of 1.

The problems outlined above can be made concrete by examining Table 33.[51] This assumes that the proceeds of a federal cigarette tax of 2 cents per package and 50 per cent of the yield of other tobacco taxes for the fiscal year 1941 are apportioned among twenty-four states, all of which levied tobacco taxes. Apportionment is reckoned on two bases: (a) unweighted population, (b) population with urban weighted 1.5. In the former case six states would not receive as much tobacco tax revenue as they received in 1940; in the latter case only two states would not receive as much as in 1940. The table indicates also that the rural states would, in general, secure a very marked increase in their revenues if sharing rested upon unweighted population.

On grounds both of history and of administrative convenience the tobacco taxes offer perhaps the most feasible prospects for successful coördination by means of federal collection and state sharing. Any such scheme would, of course, encounter opposition as an impairment of state sovereignty. Even aside from this, individual states would squabble about their proper share of the revenue. The scheme would naturally be costly to the federal treasury which would sacrifice revenue in order to provide the nation with a better system of tobacco taxes. One may doubt that an attempt should be made to advance the scheme by itself. As part of a more far-reaching revision of federal–state fiscal relations federally collected and state-shared tobacco taxes have a definite place.

[51] *Federal, State and Local Government Fiscal Relations*, p. 508.

TABLE 33

PROPORTION OF 1940 STATE TOBACCO TAX RECEIPTS THAT WOULD BE RECEIVED BY 24 STATES FROM FEDERALLY SHARED TOBACCO TAX DISTRIBUTED ACCORDING TO UNWEIGHTED TOTAL POPULATION, WEIGHTED URBAN POPULATION[a]

State	Percentage of 1940 State Receipts: Unweighted total population formula	Percentage of 1940 State Receipts: Weighted urban population formula
A. States receiving more by weighted formula:		
1. Connecticut	98.3	102.0
2. Massachusetts	94.2	106.3
3. New York	98.0	108.0
4. Ohio	110.3	114.7
5. Pennsylvania	138.2	143.6
6. Rhode Island	99.2	113.9
Simple average	106.4	114.8
B. States unaffected by weighting:		
1. New Hampshire	85.4	85.4
2. Utah	274.6	274.6
C. States receiving less by weighted formula:		
1. Alabama	137.1	123.1
2. Arkansas	197.6	171.0
3. Georgia	176.7	161.8
4. Iowa	209.3	198.4
5. Kansas	242.9	228.7
6. Kentucky	263.2	236.4
7. Louisiana	73.0	68.5
8. Mississippi	136.2	116.5
9. North Dakota	205.1	175.8
10. Oklahoma	157.5	145.1
11. South Carolina	117.0	102.3
12. South Dakota	167.8	147.3
13. Tennessee	157.3	143.9
14. Texas	139.8	133.7
15. Vermont	129.1	119.6
16. Washington	134.9	132.9
Simple average	165.3	150.4

[a] Distribution of 2 cents per package of Federal cigarette tax receipts and 50 per cent of the yield of other tobacco taxes for fiscal year 1941.

LIQUOR TAXES

The need for revenue and Alexander Hamilton's desire to stake out broad claims to sources of taxation for the national government led to imposition of a federal excise on distilled spirits of 60 cents per gallon in 1791. It is a matter of history that in Pennsyl-

vania the tax was the proximate cause of the whiskey rebellion,[52] and this poor reception brought its disappearance from the tax system. A gallonage tax on spirits, which it is the real predecessor of modern federal levies, was imposed in 1863. Starting at 20 cents, the rate was sharply raised until in 1866, with a rate of $2.00, Congress found that its zeal for painless taxation had far outstripped the administrative capacity of its revenue officers. Gross evasion was the rule,[53] and as an aid to fiscal reform the rate was drastically lowered. Not until 1917 did the gallonage tax again reach the level of 1866.[54] The federal government also collected customs duties on imported spirits, the rate just before prohibition being $2.60 per gallon, no internal revenue tax being charged. At this same time wine was taxed by the federal government at 10 to 40 cents per gallon, and beer at $1.50 per barrel. Customs duties on wine ran from 45 cents to $3.00 per gallon or more on luxury wines. In addition to the federal levies, the liquor industry was subjected to various state and local levies mostly in the form of occupational or license taxes on manufacture and sale. The states and localities had hardly entered the field of commodity taxation and they did not show a large revenue from the liquor industry.[55]

As prohibition sentiment gathered force, the localities and states began to go "dry" in piecemeal fashion, and this raised difficulties of enforcement, the most obvious of which centered around the Supreme Court's interpretation of the interstate commerce clause. The Court held in 1890 [56] that a state could not prohibit sale of liquor in original packages, and as a result liquor flowed without impediment across the boundaries of dry areas. Congress promptly came to the rescue by passage of the Wilson act (1890) which declared that liquor coming into a dry state was to become

[52] The tax was dropped in 1802. License taxes were reimposed in 1813 and dropped again in 1817.

[53] A. S. Bolles, *The Financial History of the United States, from 1861 to 1885* (New York, 1886), pp. 416–38.

[54] Details of the rates of tax on all sorts of liquor, and of the revenue collected, can be found conveniently in the Interdepartmental Report to the Secretary of the Treasury, printed as a supplement to the Joint Hearings on Tax on Intoxicating Liquor before the House Committee on Ways and Means and the Senate Committee on Finance (U.S., 73rd Congress, 1st and 2nd sessions, 1933).

[55] In 1916 state and local revenue from the liquor traffic was perhaps one-quarter of the federal revenue ($262,500,000) from this source. See Interdepartmental Report, pp. 348–49, 378–79.

[56] *Leisy* v. *Hardin*, 135 U.S. 100.

subject to the state law on its "arrival." But this attempt at remedy failed when the Court decided in 1898 [57] that "arrival" meant delivery at the final destination. A state could not possibly check upon the thousands of consumers who might order liquor by mail or otherwise from an out-of-state seller. Not until 1913 did Congress take a further step to assist those states which wished to be insulated from the "wet" areas. Then, by the Webb-Kenyon act, liquor was really divested of its rights as an article of interstate commerce. Trade in intoxicating liquor was not to be interstate trade; and although President Taft in a veto message [58] warned that suspension of the commerce clause to assist the police power of the states had its dangers, Congress preferred to take the risk. In 1917 Congress took a further step when, by the so-called "Reed amendment," [59] it added a federal penalty to existing state penalties against those who brought liquor into "dry" states.

By the eighteenth amendment the federal government and the states were supposedly joined in enforcement of prohibition, since they had "concurrent power to enforce this article by appropriate legislation." [60] The ineffectiveness of this effort is a recent memory. Some state governments gravitated from mere failure to coöperate toward overt resistance of federal efforts, until at last the twenty-first amendment swept away national prohibition. But it did not sweep away the variety of attitudes from state to state. Table 34 shows that, in most of the thirty-eight states which had voted on the issue up to December 5, 1933, there was a substantial "dry" sentiment; and it should be remembered that the six states which had *not* voted were generally "dry." Moreover, the "wets" in one state did not want the same sort of liquor laws as those in another; and the problems of liquor control in, e.g., California, with no large centers of population just outside its boundaries, were different from those of New Jersey; while the problems of both were unlike those of Vermont. No neat solution was manifest which state legislatures could adopt; and the public attitude, after the excitement of repeal, suddenly became apathetic. Of one thing the legislatures were

[57] *Rhodes* v. *Iowa,* 170 U.S. 412.
[58] *Congressional Record,* vol. 49, p. 4291–92.
[59] 39 U.S. Statutes 1069 (1917).
[60] Article XVIII, Section 2.

TABLE 34

PERCENTAGE VOTE BY STATES FOR THE TWENTY-FIRST AMENDMENT[a]

Percentage	Number of states
85.0–89.9	5
80.0–84.9	4
75.0–79.9	8
70.0–74.9	3
65.0–69.9	5
60.0–64.9	7
55.0–59.9	3
50.0–54.9	1
45.0–49.9	1
40.0–44.9	..
35.0–39.9	..
30.0–34.9	..
25.0–29.9	1
	38

[a] Derived from Harrison and Laine, *After Repeal* (New York, 1936), p. 230.

certain—that they should use this opportunity to build up the state revenues.

The federal attitude about liquor control was hardly more coherent than that of the states. The federal government had the responsibility of protecting the dry states, and the task, along with the states, of eliminating the bootlegger. Like the states, it was determined to secure a substantial revenue from the liquor industry.

The influence of the revenue motive, which blanketed almost every other, was not wholly fortunate. An initial difficulty was that Congress and the states started from different premises. Congress in its thinking tended to revert to the revenue pattern of pre-prohibition days when gallonage taxes were federal and occupation taxes state and local. This, as in 1916, would have given the federal government the big slice of revenue. But the states were of a different opinion. In 1933–34 commodity taxation was no longer a federal preserve, and the states were convinced, with excellent reason, that their need for revenue exceeded that of the federal government. The argument on the grounds of precedent and tradition was particularly irritating to the states because the federal government had just imposed a gasoline tax

and raised the federal estate tax outside the crediting scheme.[61] Many people feared that all levels of government, greedy for revenue, might act without proper regard for social control of the liquor business. The bootlegger had been a menace in American life for a decade. It was beyond cavil that high taxes, and therefore high prices, for legal liquor would hinder his eradication.

The scheme to prevent intergovernmental conflict over liquor taxation which received most attention provided for federal collection and state sharing. An interdepartmental committee of officers from various federal services suggested that, if the states refrained from gallonage taxes, 20 per cent of total federal receipts from internal taxation of liquor should be returned to them, the allocation being based upon state production and consumption.[62] The Interstate Committee on Conflicting Taxation, assuming that the federal government collected the gallonage tax, asked that the combined gross revenues of all governments from the liquor traffic be shared 50–50 on the basis of population.[63] This latter proposal was, of course, much more generous to the states than the former, and the gap between the two indicates that the federal government and the states were far from common ground. The outcome was that Congress proposed no plan for sharing, and the states, as soon as they had the power, began to collect gallonage taxes [64] as well as other levies.

This failure to reach agreement was most unfortunate. The federal government has an advantage in collection of liquor taxes because it collects at the points of production, which are relatively few, whereas the states have usually to collect close to consumption from wholesalers and retailers.[65] The federal internal revenue officers attend to about 300 distilleries and 200 bonded

[61] Mr. Toll, in presenting the case to the Joint Committee, referred to this federal legislation, adding: "I am not attempting to create any impression that either the Federal Government or the State governments have vested interests in any source of tax revenue, but the Federal Government has felt it was proper for it to participate in available revenues formerly enjoyed by the States. Then, when the States say . . . let us participate in this new source of revenue [liquor], would it be consistent for the Federal Government to say, 'Let us look back to the days of 20 years ago in this matter.' In other words, they say, 'In what is yours we will share with you, and what is ours by tradition, is ours.'" U.S. 73rd Congress, 1st and 2nd sessions, Joint Hearings on Tax on Intoxicating Liquor, p. 252.

[62] Joint Hearings, p. 338.

[63] *Ibid.*, pp. 242–54.

[64] Some made provision for modification in case a sharing plan was provided.

[65] Licensing may be supposed to be a state-local matter.

warehouses. Taxes are paid, in the main, at the time the liquor is withdrawn from the warehouses, or, in the case of imported liquor, at the time of importation or withdrawal from bond. The liquor is put in bottles, serially numbered, manufactured by licensed companies, and sold only to licensed distillers and importers. Undoubtedly legal manufacturers pay federal liquor taxes with little, if any, evasion.[66] The system of taxing early in the production process has been criticized as leading to a pyramiding of taxes as a cost, but the treasury has opposed attempts to force it to collect at a later point of sale with the argument that this would be inordinately expensive and conducive to frauds;[67] and this is a conclusive answer. The difficulties in the way of state taxation of liquor will be discussed later. For the student of federal–state relations the ugly outcome was the complete failure in 1933 of the negotiations for coöperation, despite many favorable circumstances. Here was a new source of revenue. It was not as if the states were already levying a hodgepodge of rates and had become dependent upon whatever was their particular amount of collections. Yet the opportunity was passed by because of disagreement between the federal government and the states over the proper share of each, and disagreement among the states over the proper basis for distribution to them.

The liquor taxes which Congress imposed immediately after repeal were consistently higher than those of the pre-prohibition period. On distilled spirits the federal excise was $2.00 per gallon, compared with $1.10 in 1916. Imported spirits paid $5.00 per gallon, together with the excise, whereas in 1916 only a duty of $2.60 per gallon was paid. Federal taxes on wines and beers were also at a higher level. "The tax on heavy wine was $.40, formerly $.25, which represents an increase of 60 per cent; that on light wine was $.10, formerly $.04, an increase of 150 per cent; that on beer was . . . $5.00 per barrel, formerly $1.50, an increase of 233 per cent. The import duties were similarly in creased."[68] Besides indicating a greed for revenue the high cus-

[66] Illegal manufacture and import are attacked by investigation, seizure, and prosecution. See Stewart Berkshire, "Liquor Law Enforcement Work of the Treasury Department," *Proceedings of the National Conference of State Liquor Administrators,* 1936, pp. 164–69.

[67] U.S., 74th Congress, 2nd session, Senate Hearings on H.R. 9185 before the subcommittee on finance, Liquor Tax Administration.

[68] Harrison and Laine, *After Repeal,* p. 184. The federal government also began to levy "license" fees or occupational taxes, the purpose being to give revenue

toms duties were thought of as a bait which could be used to secure trade concessions from countries wanting access to the new American market. Obviously such a policy disregarded the bootlegging problem, a disregard which was the more serious because legal dealers in the United States had very limited stocks to meet consumers' demand. In short, Congress in these post-repeal years showed an unstatesmanlike attitude for which there was little excuse.[69] As a result bootlegging remained widely prevalent for two or three years after repeal.

By 1936, however, a change for the better occurred.[70] The trade agreements lowered duties on foreign spirits and wines; the supply of American liquor increased and its quality improved; federal enforcement was pushed; and the attitude of the public toward the bootlegger was revised. With the defense emergency and then war, Congress pushed liquor taxes to new high levels. By the revenue act of 1944 the excise on spirits became $9 per gallon, and that on fermented malt beverages $8 per barrel. In normal times these rates would have been impossible, but at present patriotic feeling, together with full employment and short supplies, have eased the administrative task of enforcement.

Confusion in liquor control at the state level has multiplied steadily since repeal. Undoubtedly it was a delusion, in view of the diverse attitudes, to hope for a singleness of aim; but even the most pessimistic forecasts of 1933 erred in optimism.

In classifying the states it is usual to group them as (1) dry, (2) wet with state stores—the monopoly states, seventeen in number, (3) wet with private stores—the license states, of which there are twenty-eight. Within each of these, however, no uniform pattern appears. Dry states may permit sale of beer; the

officers a means of search to trace taxable liquors. Upon payment of the levy, the federal government gives a special stamp which is regarded by it merely as a receipt. The states, however, have sometimes looked upon this as a federal license and they have objected because it has sometimes been given to persons who have violated state laws. The federal government has insisted that the tax receipt gives no right to sell in violation of state laws, and, in the main, its defense is satisfactory. But its officers are infringing the spirit of the law when, in states which have government stores, they issue tax receipts to persons who can only be running speak-easies. See *Proceedings of the National Conference of State Liquor Administrators,* 1938, pp. 13–16; 30–41.

69 See the criticisms offered by Harrison and Laine, pp. 17–41.

70 The best measure of the volume of the bootleg business is mash gallons seized, and this declined from 21,373,000 in 1935 to 6,480,000 in 1940.

monopoly states usually allow sale of liquor in hotels; in the license states there may be state control or various degrees of local responsibility. For this study the important confusions concern revenue policy and revenue administration. Here the states have been unable to reach agreement about even simple details. For example, a good many states—especially neighboring states—exchange information about interstate shipments of liquor, but very few have adopted a uniform type of report. Again, most states require affixing of decalcomania stamps to containers as evidence of tax payment; but agreement as to how and where these are to be affixed has not been reached, and state regulations have often been cumbersome and costly to dealers.[71] Innumerable instances could be given in which state administrators, aiming at the same ends and unfettered by legislative restrictions, have chosen very different techniques. To variety of this sort is added that which stems from dissimilar state laws. Uniformity of legislation is, of course, out of the question in the face of a lack of uniformity in public opinion. But the wasteful diversity of administrative practice is much in excess of what can be explained in terms of diversity of public attitudes.

It was inevitable, when the attempts to secure some sort of federally-collected state-shared liquor taxation broke down, that the states should come into conflict with each other and with the federal government. Even before the federal government had framed its taxes, the states began to tax at very divergent rates and on diverse bases. At once they encountered the manifold problems associated with taxation of interstate commerce, and here the situation was complicated by the form of the twenty-first amendment and by its judicial interpretation. The amendment declared that "the transportation or importation into any State, Territory or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." This was the essense of the Webb-Kenyon act of 1913. The interstate commerce clause was suspended in

[71] *Proceedings of the National Conference of State Liquor Administrators*, 1936, p. 169. When Rhode Island found that its licensees were bringing in and selling Connecticut liquor without payment of the Rhode Island tax, it required affixing of stamps on all containers before they entered the state. This meant inconvenient opening of cases and extra cost of transportation. In the Hearings before the Temporary National Economic Committee, vol. 12, p. 495, Georgia, Missouri, Wisconsin, and Ohio are cited as causing similar difficulties.

its application to liquor for the purpose of allowing states to be "dry" if they chose.

But once again, as in earlier liquor legislation, Congressional intention and judicial interpretation of the law did not jibe. The first important liquor case to come before the Supreme Court involved the right of California, a "wet" state, to impose a $50 license fee on distributors for the privilege of distributing California beer, and a $500 fee if they wished to distribute foreign—out-of-state—beer. Was this an infringement of the commerce clause? The Court answered in the negative. "The [twenty-first] amendment abrogated the right to import free, so far as concerns intoxicating liquors." [72] Subsequent cases have strengthened the force of this decision, and therefore no shift in interpretation is likely. A different interpretation would, so the Court declared, "involve not a construction of the amendment, but a rewriting of it." The practical effect of the decision was not simply to protect "dry" states, but to open the way to interstate tax discrimination and to trade barriers in liquor, although the states needed no stimulus in ill-doing.

The grounds which can plausibly be used to justify discrimination are numerous. It can be argued that differentiation between distributors of domestic and out-of-state liquor in issuance of licenses is warranted on grounds of public health; that, for similar reasons and in order to protect the state revenue, out-of-state dealers must be registered. Administrative regulations supplementary to the statute law can be employed very flexibly to serve the purposes of a state tariff. Indeed, the possibilities of dressing up economic protectionism in a state police uniform are legion.[73]

[72] *State Board of Equalization* v. *Young's Market Co.*, 299 U.S. 59. Subsequent related cases are *Mahoney* v. *Joseph Triner Corp.*, 304 U.S. 401; *Indianapolis Brewing Co.* v. *The Liquor Control Commission of the State of Michigan*, 305 U.S. 391; *Finch and Company* v. *McKittrick*, 305 U.S. 395. See R. L. Wiser and R. F. Arledge, "Does the Repeal Amendment Empower a State to Erect Tariff Barriers and Disregard the Equal Protection Clause in Legislating on Intoxicating Liquors in Interstate Commerce?" 7 *George Washington Law Review* 407 (1939).

[73] For some examples see "Liquor Control: The Latest Phase," *Columbia Law Review*, April 1938, especially pp. 648–53; and also the excellent study by Thomas S. Green, Jr., *Liquor Trade Barriers; Obstructions to Interstate Commerce in Wine, Beer and Distilled Spirits* (Public Administration Service, Chicago, 1940); also E. S. Keltz, Discriminatory Legislation affecting Alcoholic Beverages, *Proceedings of the National Conference of State Liquor Administrators*, 1937, pp. 199–204. Mr. Keltz wrote: "Discriminatory legislation programs displayed infinite ramifications. By some measures greater and almost prohibitory license fees were assessed

One student found that many states differentiated against out-of-state producers in their license fees by subjecting them to a fee with no regard to the fact that one had already been paid in the state of residence, and against wholesalers who distributed liquor produced out-of-state by higher license fees. Beer is favored (1940) by license fee differentials in twenty-four states.[74] Beer is produced in many states, often by small breweries, and therefore the protective motive has widespread and obvious force. Wine is favored by license fee differentials in twenty-six states, although other methods of discrimination are also used. In fourteen states distilled spirits are also given preference by license fees and in two by differential excises, although only twenty states produced any distilled spirits, and 98 per cent is produced in nine states. "The only conclusion which can be derived is that barriers affecting this alcoholic beverage are offshoots of a development which finds its roots in legislation and regulations directed against beer and wine."[75]

One of the most interesting example of interstate conflict arose out of an Indiana law which restricted import of beer to a number of special importers. Its neighbor, Michigan, had an anti-discriminatory beer law which barred the import of beer from states which discriminated against Michigan beer, and Indiana naturally was due to come under the embargo. In this case Indiana would have been the direct loser because it exported much more than it imported. At the last minute, and by an agreement which was extralegal, an armistice was arranged.[76] Similar scuffles have taken place elsewhere, and although the spectacle has often been reminiscent of opera bouffe, it has also been costly to consumers and to producers.

The so-called anti-discriminatory legislation which, after 1937,

against distributors of outside products, while distributors of local products benefitted by nominal tariffs. Some states levied direct license fees on outstate manufacturers for the privilege of selling through state licensees. Some differentiated in the beverage tax scale or in warehousing requirements or in distribution methods, but all of these legislative devices aimed to give selfish advantage to manufacturers in the states adopting them" (p. 201).

[74] Green, *Liquor Trade Barriers*, p. 16. The two greatest exporting states, Wisconsin and Missouri (Schlitz Brewing Co., and Premier Pabst Brewing Co., in Milwaukee, and Anheuser-Busch in St. Louis), have passed no trade barrier legislation affecting beer (p. 18).

[75] *Ibid.*, p. 19.

[76] Green, p. 20.

was passed by a few states and considered by many, is an extreme form of state belligerence.[77] By it all alcoholic beverages coming from states which discriminate against the products of a given state are to be prohibited to dealers under penalty of loss of license. What constitutes discrimination may be defined at length or left to the discretion of administrators, but in all cases the end result is likely to be as capricious as an individual's conscience. If defined in detail, the application of discrimination will be dangerously inflexible; if left to administrative discretion, it will be dangerously flexible. Instances have been reported where states with no breweries have been accused of discriminating against the beer of a given state, and where innocent regulations have been declared to be discriminatory.[78] Another less drastic type of action is the so-called "retaliatory" statute, common in insurance legislation. It has been used by at least four states—Pennsylvania, Ohio, Connecticut, Rhode Island—and by it the rate charged in state A on liquor from state B is what state B charges the liquor of state A. A state in effect declares: "I intend to do to each other state what it does to me." While this sort of legislation might seem to have the justification that it aims at reciprocal abolition of discrimination, the experience with it in insurance statutes has not been satisfactory and certainly it greatly complicates the administration and reckoning of taxes.

The National Conference on Interstate Trade Barriers in 1939 served at least to halt the spread of discriminating liquor legislation, and during the period of the war some improvement may be expected. But in view of the fiscal condition and the broad constitutional powers of the states, conflicting liquor taxation is bound to be a perennial problem.

Any summary of state taxation of liquor hides its full variety. In 1940 excises on spirits ran from a low of 40 cents a gallon in Nevada to a high of $2.00 in Maine and Vermont,[79] with the average at about $1.00 On wines the rates ran from one and two cents in California to 60 cents in Georgia, although in general the wine taxes are not heavy and the lighter wines are favored. Beer

77 Hearings before the Temporary National Economic Committee, vol. 12, p. 490.

78 Repeal Associates, *Discrimination and Retaliation among the States* (Washington, 1939), pp. 6–7.

79 These two states operate a state-store system and the tax is collected when making the sales.

taxes vary from less than 2 cents per gallon to 16 cents, with the average about 5 cents. The states (and localities) also impose license fees or occupational taxes upon manufacturers, wholesalers, and various types of retailers, but these baffle brief description beyond the statement that the levies upon manufacturers are highest and those upon retailers the lowest. It should be remembered also that, in the monopoly states, both the excise and the equivalent of fees are usually collected in the price charged the buyers.

Most students hoped that the states, after repeal, would adopt the monopoly system rather than private sale. In fact only a fringe of states near the Canadian border, together with a few others in which the "wet" majority was small, turned in this direction. State monopoly is favored as a more effective means of social control, because prices can be readily adjusted to encourage temperance; because advertising, hours of business, excessive multiplication of outlets, and misrepresentation of products become questions of state policy; and because law enforcement is simplified. These advantages may, however, be nullified by corrupt or inefficient political administration, and fear that this might come to pass, together with an impatience of governmental regulation, lead the people of many states to favor licensing.

Looking to the long future it would seem feasible to make taxation of liquor principally a state source of revenue. Federal controls over production would be retained, but without being coupled with anything more than regulatory taxation.[80] If federal taxation was thus narrowed, and if the monopoly system prevailed in all the states, the states might agree to tax liquor only by making direct additions to the prices at which they sold to consumers —with no discrimination against out-of-state products. Federal conditions could be stipulated which would bind the states to eschew discriminatory practices, but which would, nevertheless, allow them to raise as much or as little revenue from liquor sales as they desired. Divergence of price lists between neighboring states would cause no serious trouble when the outlets were state stores.

A reader may reflect that this framework requires drastic assumptions. In fact this is not so. The monopoly system is no innovation and its general adoption is desirable. The presence of this feature would make possible state retention and expansion

[80] To this customs duties could be added.

of liquor taxation, as its absence in the case of any other commodity impedes—and often debars—successful state taxation. Imposition of federal oversight here *would* be an innovation, but the oversight would be designed to do for the states what they cannot effectively do for themselves. Unlike the oversight associated with grants in aid, this oversight would not affect or control the way the state liquor revenues were spent. Unlike the scheme of federal collection with distribution to the states, it does not pose questions about the *basis* for distribution. In short, here is a method for separation of a source of revenue which could be achieved over a period of years, and in a federalism something can be said for a separation of sources. The proposal does not, it should be recognized, stand by itself; it is part of a larger scheme for reform.

CHAPTER XV

DEATH TAXES

Primitive conditions have passed; business is now transacted upon a national scale. A very large part of the country's wealth is invested in negotiable securities whose protection against discrimination, unjust and oppressive taxation, is matter of the greatest moment. . . . Taxation is an intensely practical matter, and laws in respect of it should be construed and applied with a view of avoiding so far as possible, unjust and oppressive consequences. . . .

JUSTICE MCREYNOLDS.[1]

If we enjoyed the freedom of the framers [of the Constitution] it is possible that we might, in the light of experience, devise a more equitable system of taxation than that which they gave us. But we are convinced that this end cannot be attained by the device of ascribing to intangibles in every case a locus for taxation in a single state despite the multiple legal interests to which they give rise and despite the control over them or their transmission by any other state and its legitimate interest in taxing the one or the other.

JUSTICE STONE.[2]

UNTIL 1916 the federal government used death taxes only in periods of emergency and it repealed the taxes promptly after the emergency had passed. The first federal death tax, 1797–1802, was of slight importance; that levied 1862–1870, as a result of the Civil War, brought in a substantial revenue, and so also did the tax levied 1898–1902 as a result of the Spanish–American war. These episodes indicated the belief of Congress—a belief criticized by economists—that death taxes, while suitable as temporary levies, were undesirable or unnecessary for federal purposes in time of peace.

Meanwhile, the states had timidly entered the field of death taxation. Pennsylvania is usually cited as the first state to levy a true inheritance tax in 1826, and before the Civil War six more states [3] had followed its example. Then there was a lull until, in 1885, New York passed a statute which in draftsmanship and ad-

[1] *Farmers Loan and Trust Company* v. *Minnesota,* 280 U.S. 204.

[2] *State Commissioner of Utah* v. *Aldrich,* 316 U.S. 174.

[3] See U.S. Congress, Report to the Joint Committee on Internal Revenue Taxation, *Federal and State Death Taxes* (Washington, 1933), p. 53.

ministrative provisions was to be a model for many years. By 1891 nine states had taxes,[4] all of them taxing collaterals only and at flat rates varying from 2½ per cent to 5 per cent. In the next period, 1892 to 1916, several major changes took place. Under pressure for additional revenue and stirred by the agitation against concentration of wealth, the number of states with death taxes rose to forty-three, leaving only Florida, Mississippi, New Mexico, South Carolina, and Alabama without them. And taxation of direct heirs, as well as collaterals, together with progressive rates, had been initiated. By September 1916, thirty-one of the forty-three states taxed both direct and collateral heirs; [5] twenty-eight had progressive rates which, on the average, were from 1 to 3 per cent on direct heirs and 5 to 11 per cent on collaterals. From these levies the forty-three states in 1916 secured $30,748,000—8.4 per cent of their tax revenue.[6]

In the first decade of the twentieth century the federal government was in no need of additional sources of revenue, but the muckracker agitation against concentration of wealth stimulated Theodore Roosevelt to recommend in 1906 that Congress impose a progressive inheritance tax. Against this recommendation there was at once a strong protest. The conservatives, who disliked any extension of death taxes, were joined by those who feared a diminution of state sources of revenue. Certainly it was apparent that for fiscal reasons the states needed death taxes as the federal government did not, and the National Tax Association expressed the opinion that inheritance taxes "should be reserved wholly for the use of the several states." [7] For some time this opposition was effective in preventing federal action, but when in 1916 Congress was faced by a "preparedness" program which called for a heavy expenditure, the opposition collapsed. The federal government had now a need for more revenue, and it could, besides, be pointed out that the states, while in possession of death taxes, had not used them to good effect. The low rates, the very modest progression, the over-generous treatment of direct heirs, together with the clear symptoms that discriminating levies were beginning, weakened the claim of the states to preëmptive rights in this field.

[4] *Ibid.*, p. 53. Some states had entered and then retired from the field.
[5] Eleven taxed collaterals only, and one had an estate tax only. *Ibid.*, p. 57.
[6] *Ibid.*, p. 249.
[7] National Tax Association, *First National Conference, State and Local Taxation* (New York, 1908), pp. 662–63.

It was even possible to argue that federal participation might stimulate the states to more vigorous and successful action.

Then came the first World War and for some years nobody seriously questioned the federal estate tax. But when in the 1920's there were large federal surpluses, despite abolition or sharp reduction of many federal levies, many people came to the belief that federal withdrawal from the field of death taxation was desirable. The states once again were feeling the pinch as their expenditure for highways and other services grew steadily. Against federal withdrawal were arrayed those who, in 1924 as in the time of the first Roosevelt, wanted high death taxes on social grounds. Even if the states could manage the taxation of moderate inheritances with success, it was felt that they could not handle higher rates on large inheritances. In Congress at the time was a curious political alignment. The Democrats, although in a minority, often received the support of the insurgent Republicans in both the House and the Senate, and as a result some of the attempts of the Coolidge administration to reduce taxes were blocked. So it was with the estate tax. In spite of the outspoken condemnation of this tax by the president and Mr. Mellon, Congress raised the range of rates from 1–25 per cent to 1–40 per cent and it provided that a 25 per cent credit against the federal estate tax would be given for death duties paid to the states.

At this time two states, Florida and Alabama, were without death taxes. Florida had never had a tax, but in November 1924, by constitutional amendment it forbade enactment of either inheritance or income taxes. The purpose of this move was only too apparent: by supplementing the attractions of its climate with the establishment of a tax-haven, Florida hoped that rich people would domicile themselves within its borders. Since domicile for the purpose of taxation was easy to establish, the other states had reason to fear the migration of estates beyond their jurisdiction. Nevada promptly met the threat, or rather it became an imitator of Florida, by passing a similar constitutional amendment in July 1925; while California, which had up to this time been the natural competitor of Florida as a domicile for retired millionaires, discussed the need for parallel action.

Nothing more was needed to bring home the realization that the future of death taxes as a source of state revenue was in serious jeopardy. At the very time when many state officers were

urging federal withdrawal from the field, here were signal illustrations of the inability of the states to use a system of death taxation with success. And the most casual survey indicated that there were other weaknesses in the state taxes. Rates, exemptions, definitions, administrative practices were diverse; and while complete uniformity in these matters was not to be hoped for, the existing variation was beyond reason. Even more dangerous were the discriminatory practices which had grown up, particularly in the taxation of nonresident decedents. Some attempt to clean house was imperative, and at the meeting of the National Tax Association in September 1924, a resolution was adopted recommending that the Association assemble a conference of federal as well as state representatives to consider remedies for the existing difficulties over death taxation.[8] In February 1925, the conference met at Washington. Delegates appointed by the Governors attended from twenty-five states, and President Coolidge, addressing the conference, promised his "cordial coöperation." After thorough discussion it was voted that the chairman, Dr. T. W. Paige, should appoint a committee of investigation which was to report recommendations to a second national conference.[9] A committee of nine members was named with F. A. Delano as chairman, and it reported in November, 1925.

Death Taxation in 1925

Let us survey the condition of death taxation at this time. The dangers of disintegration of the state taxes because of the actions of Florida and Nevada have already been mentioned, and it need only be emphasized that they had a decisive influence in the sequel. Of longer standing was the existence of multiple and overlapping taxation. When in the 1900's the states had crowded into the field of death taxation, it was not long before the problem attracted attention. The National Tax Association in 1907 at its first conference began to search for remedies, and several states—Massachusetts in particular—attempted to give a lead to their erring brethren. The greatest abuse arose because the states, in addition to taxing *all* the intangible property of their own decedents, taxed also the intangible property of nonresidents which could in

[8] National Tax Association, *Proceedings of the National Conference on Inheritance and Estate Taxation*, 1924 (New York, 1925), p. v.

[9] *Ibid.*, pp. 192–93.

law be held to have a situs within their boundaries.[10] There was here a profusion of legal rules for which authority could be claimed. The state of domicile of the decedent might claim the right to tax the intangibles in his estate by the rule of *mobilia sequuntur personam*—and every state did this in 1925. A state might also claim the right to tax the intangibles in the estate of a non-resident decedent if these consisted of, e.g., shares of stock of a corporation chartered by it—and thirty-six states did this. A state might also claim the right to tax intangibles if these were *physically* located within its boundaries, e.g., in a safe-deposit box, even though the securities had been issued by an out-of-state corporation—and sixteen states did this. A state might also claim the right to tax the transfer of intangibles issued by an out-of-state corporation and not physically situated within its boundaries, if the corporation had property within the state—and eleven states claimed this right in 1925.

> If, therefore, a resident of Wisconsin should die owning stock of a New Jersey corporation and the certificate of stock happened to be deposited in a safety deposit vault in Missouri, and the corporation owned property in North Carolina, before the property could be transferred by the executor it would be necessary to pay inheritance taxes on the stock to the State of Wisconsin, the State of New Jersey, the State of Missouri, and the State of North Carolina. In addition, if the estate is over $50,000, he must pay a tax to the Federal Government. If this stock happened to be that of a company also incorporated in states other than those enumerated, such other states would have to be added to the list. Some railroads are incorporated in five or six states, and the shares of stock are taxable in each upon the death of the owner. The situation as to bonds, notes and other obligations is equally deplorable. . . .[11]

The possibility of discriminatory taxation was therefore great and a large investor could be perfectly safe only if he restricted himself to his own state.

This fiscal anarchism rested upon a basis more substantial than the perversity of the states and their greed for revenue. There is, for instance, nothing unreasonable in the argument that a

[10] Taxation of real estate raised no problem of multiple taxation because it was declared to have a situs only where situated. During the deliberations of the committee the Supreme Court in *Frick* v. *Pennsylvania,* 268 U.S. 473, settled that the same rule applied also to tangible personal property, thus eliminating the possibility of multiple taxation of this sort of property.

[11] *Proceedings of the National Conference on Inheritance and Estate Taxation,* 1924, pp. 41–42.

state in which a corporation owns property and does business has the right to tax the transfer of that property by death duties even though the corporation received its charter from another state. The legal doctrine which treats the corporation as a separate entity is a fiction, and there is no inherent justice in the proposition that the shares should be taxed only by the state of resident of the decedent. There is, of course, reason in the proposition that they should not be taxed on several different bases by different states, each selecting the one which suits its circumstances; and many states showed insincerity in their attachment to any basis by enacting death taxes which rested on several. The point then is that logic and justice indicated several simple solutions no one of which was equally attractive to all the states. Besides framing a plan which would do justice to the individual tax-payers, it was necessary to do justice to the tax-collecting states,[12] and this was far from easy. The National Tax Association endorsed taxation of intangibles according to the domicile of the decedent, and the Delano committee declared that this was the only "equitable and practical rule." [13] Unfortunately the states differ markedly in economic maturity, and debtor states and states which charter many corporations cannot be expected to be satisfied with such a rule. The Delano committee was not unaware of this conflict of interest and it endorsed, as a second best alternative, the so-called Matthews plan. By it a state may levy a flat-rate tax of 2 per cent upon all personal property belonging to non-resident decedents over which it has jurisdiction. In principle there is here no solution of the injustice of multiple taxation, but the practical injustice is minimized by the low rate of the tax and by the ease of administration.

Many other defects in the system of state death taxes needed remedy. The lack of uniformity in rates, exemptions, and definitions, together with complicated administrative rules and bureaucratic administration, led to inconvenience, delay, and heavy expense in the settlement of estates.

In order to determine whether taxes are chargeable, the laws of each state required the executor to secure a waiver before transfering any property

[12] W. J. Shultz, *The Taxation of Inheritance* (Boston, 1926), p. 247.

[13] *Report of the National Committee on Inheritance Taxation to the National Conference on Estate and Inheritance Taxation Held at New Orleans, Louisiana, November 10, 1925* (1925), p. 48.

coming within the provisions of its laws. To secure this waiver it becomes necessary for the executor to prepare the necessary forms and such other papers as the law of the particular state may require. The preparation of such papers involves expense even though frequently, because of the exemptions and deductions allowed, no taxes whatever are payable. These forms are by no means similar in the various states, and it is often necessary to prepare a number of different sets for a single estate.[14]

This sort of compliance cost was not confined to large estates and the Delano committee declared that it brought "condemnation of the entire inheritance-tax system" and was "a reflection upon the intelligence and common sense of the American people." [15]

The Eighty Per Cent Credit

It will be remembered that one drive behind the creation of the Delano committee had been agitation for complete repeal of the federal estate tax. The 25 per cent credit provision had not satisfied many of the critics, although at the first national conference in 1924 a few voices had been lifted in its praise.[16] The feeling of the National Tax Association and of the federal treasury was that by tradition, legal theory, and revenue necessity, the death tax belonged to the states. Certainly the states had been longer in the field, although Congress in 1916 did not, as on earlier occasions, enact the estate tax as a temporary measure, and the tradition of successful state use of the tax had not been established. By legal theory it is a fact that the states have and the federal government has not the right to regulate the descent and distribution of property at death, but the right of the federal government to tax receipt of property at death is beyond dispute. Revenue necessity undoubtedly pressed much more upon the states than the federal government, and at a time when all federal taxes were being lowered much could be said for federal re-

[14] *Report of National Committee on Inheritance Taxation*, p. 43. "For one estate in New York, formal requirements in the nature of inheritance tax proceedings were required in twenty-two states and one foreign government, although, prior to the decedents' death his attorneys had examined his securities and made many sales for the express purpose of avoiding multiple proceedings. Had this precaution not been taken, proceedings would have been necessary in nearly forty states."

[15] *Ibid.*, p. 47.

[16] See particularly the statement of Professor T. S. Adams, pp. 117–18 of the *Proceedings of the National Conference on Inheritance Taxation*, 1924 (1925). Professor Seligman took a similar position (p. 72).

linquishment of this source of revenue, provided it would be put to good use by the states.

But about this prospect both Congress and the Delano committee were uncertain. The committee, impressed by the current misuse of death taxes by the states, desired to apply some pressure for reform more potent than mere exhortation. The 25 per cent credit provision lay at hand as an instrument and it was natural to hope that through it reform might be expedited. Why not, then, recommend increase of the credit to 80 per cent and thus stifle the anarchistic moves of Florida and Nevada, and yet set a time-limit, during which the states could clean house, for retention of the federal estate tax? This was the decision of the committee.

At this very time it happened that the Ways and Means Committee of the House of Representatives was holding hearings on revenue revision, and the Honorable W. R. Green, the chairman, invited the Delano committee to present its views about death taxes. The invitation was accepted and the recommendations were thus given to the Ways and Means Committee in advance of presentation to the National Conference on Estate and Inheritance Taxation. Undoubtedly the recommendations affected the federal decision, embodied in the revenue act of 1926, to give an 80 per cent credit against the estate tax for payments of state death taxes. Repeal of the federal tax within a period of six years, as the Delano committee recommended, was not promised, but there was a strong sentiment in Congress that, when the states obtained substantial uniformity in their own laws, repeal would be reconsidered.[17] The National Conference, as it happened, was

[17] The following dialogue in the Ways and Means Committee, arising out of a question about repeal, between Dr. T. S. Adams (who was not a member of the Delano committee) and Mr. Garner, is instructive (U.S. 69th Congress, 1st session, House Hearings, Ways and Means Committee, Revenue Revision, 1925, p. 812):

"Dr. Adams. I think that the Federal Government should wait and see. I think that you gentlemen will agree with me that if the State Governments collected 10 or 12 per cent tax on inheritances of larger size, or 12 per cent tax on inheritances of large size, and if they root out the double taxes, the demand for repeal of the Federal tax will be irresistible. As I see it the great evils at the present time are two—the excessive [federal] rates and double taxation. Now the double taxation originates with the states themselves. Double taxation is an evil which the states alone can remedy.

"Mr. Garner. There will be plenty of time for Congress to act after the States have remedied these difficulties.

"Dr. Adams. Yes."

far from enamoured with this compromise. When, a few weeks later,[18] the Delano report came before it, there was a strong sentiment, which the 80 per cent credit did not appease, in favor of demanding outright and immediate repeal of the federal estate tax. The members of the committee pointed out the obvious advantages of their recommendations, and they urged, besides, that it would be futile at this time to ask Congress to repeal the federal tax. Finally, a resolution which endorsed immediate repeal was defeated by a narrow margin.[19]

This was the turning-point of the movement for repeal. In 1926 and again in 1928, the issue came before Congress and the federal treasury pertinaciously testified for repeal as it had in 1924. But many state officers were pacified by the 80 per cent credit and pleased at the progress being made toward elimination of multiple taxation by adoption of reciprocal provisions and by decisions of the Supreme Court. Congress itself manifested an irritated impatience at efforts to drive it farther.[20] The six-year period which the Delano committee had set for retention of the federal tax ended 1931–32, but Congress, when it then prepared a revision of the revenue laws, did not even contemplate repeal. Instead, reverting to the practice of using death taxes to raise an emergency revenue, it imposed a supplementary estate tax against which the 80 per cent credit was not to apply. In 1934 and 1935 further changes were made in this tax, the effect being to bring a larger portion of the death-tax revenue into the federal treasury.

Let us look at the relative federal and state collections. As the following table shows, the share of death-tax revenue which the states secured rose sharply after 1924 because the states increased

It is of interest to note that the chairman of the committee, Hon. W. R. Green, suggested that Congress might refuse to give a state credit for a tax that had been levied on the intangible property of non-residents. It was also mentioned that restricting the credit to levy of *estate* taxes by the states might, after allowing a few years for adjustment, be a wise step (pp. 812–14). Dr. Adams pointed out that the tendency for large wills to be so drawn that total taxes were paid from the residual estate converted inheritance taxes to estate taxes in effect.

[18] The hearing before the Ways and Means Committee was on October 23, the National Conference on November 10, 1925.

[19] The vote was 16–12. *Proceedings of the Second National Conference on Estate and Inheritance Taxation* (n.d., n.p.), p. 86. Forty-one states had delegates at the Conference.

[20] See particularly United States, 69–70th Congress, interim session, House Hearings, Ways and Means Committee, Revenue Revision, 1927–28, pp. 580–826. Advocates of repeal were given a severe grilling.

their rates to take advantage of the 80 per cent credit. By 1938, however, the relative share of the states was down to a much lower figure than in 1924 not because they were collecting an absolute amount much less than in 1930, but because of the very severe jump in the federal rates and consequently in collections against which no credit was given. Increases in the federal tax occasioned by the war operated in the same direction. In 1942 the exemption was changed from $40,000 to $60,000, but the exclusion of $40,000 of insurance was dropped.

TABLE 35

FEDERAL AND STATE REVENUE FROM DEATH DUTIES[a]

	1924	1930	1938	1941	1924	1930	1938	1941
	Millions of dollars				*Percentages*			
Federal	103.0	65.0	417.0	407.0	55	26	74	77
State	84.0	181.0	145.0	119.0	45	74	26	23
	187.0	246.0	561.0	526.0	100	100	100	100

[a] E. E. Oakes, "The Federal Offset and the American Death Tax System," *Quarterly Journal of Economics*, August 1940, p. 574. Also U.S., 78th Congress, 1st session, Senate Document No. 69: *Federal, State, and Local Government Fiscal Relations*, p. 470.

REFORM BY JUDICIAL DECISION AND THE NATIONAL TAX ASSOCIATION

In these years there had been important decisions affecting death taxes by the Supreme Court. When in 1925 the Delano committee was deliberating, nobody was hopeful that reform of multiple taxation would come through judicial interpretation. In that year the Supreme Court had, to be sure, evidenced its aversion to this practice in the case of Frick *v.* Pennsylvania, but the limitation that it was to place on the right of states to tax nonresident decedents was not forecast. Only the major developments can be mentioned here. The right claimed by a state in which a corporation had property to tax shares of stock owned by a nonresident decedent was outlawed in 1926.[21] The right to tax bonds issued by a state when these were owned by a nonresident decedent was denied in 1930,[22] and in this case the Court set forth explicitly the basic premises of the new line of decisions.

[21] *Rhode Island Trust Company* v. *Doughton*, 270 U.S. 65.
[22] *Farmers Loan and Trust Company* v. *Minnesota*, 280 U.S. 204.

Primitive conditions have passed; business is now transacted upon a national scale. A very large part of the country's wealth is invested in negotiable securities whose protection against discrimination, unjust and oppressive taxation, is matter of the greatest moment. . . . Taxation is an intensely practical matter, and laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences. . . .[23]

Finally in 1932 the culmination came when the Court held that shares of corporate stock had a situs for taxation not in the state which created the corporation, but in that in which the decedent was domiciled. Pointing out that, with respect to real property and tangible personalty, the rule of one situs was well established, the Court went on to declare that, with respect to intangibles, it had recently developed a similar doctrine.

The rule of immunity from taxation by more than one state . . . is broader than the application thus far made of it. In its application to death taxes, the rule rests for its justification upon the fundamental conception that the transmission from the dead to the living of a particular thing, whether corporeal or incorporeal, is an event which cannot take place in two or more states at one and the same time. In respect of tangible property, the opposite view must be rejected as connoting a physical impossibility; in the case of intangible property, it must be rejected as involving an inherent and logical self-contradiction. . . . The contrary conclusion as to intangible property has led to nothing but confusion and injustice by bringing about the anomalous and grossly unfair result that one kind of personal property cannot for the purposes of imposing a transfer tax, be within the jurisdiction of more than one state, while another kind, quite as much within the protecting reach of the Fourteenth Amendment may be, at the same moment within the taxable jurisdiction of as many as four states, and by each subjected to a tax upon its transfer at death. . . .[24]

There was one very practical flaw in this delimitation of jurisdiction to tax by the Supreme Court: to most of the decisions a minority dissent had been registered. Justice Holmes years earlier had declared:

No doubt this power on the part of two states to tax on different and more or less inconsistent principles leads to some hardship. It may be regretted, also, that one and the same State should be seen taxing on the one hand according to power, and on the other, at the same time, according to

[23] *Ibid.* at p. 211.

[24] *First National Bank of Boston* v. *Maine*, 284 U.S. at 326–327. It may be observed that, while the Supreme Court thus restricted the rights of the states to tax intangibles, the federal government was not similarly limited in its right to tax intangibles owned by foreigners.

the fiction that in successions after death *mobilia sequuntur personam* and domicile governs the whole. But these inconsistencies infringe no rule of constitutional law.[25]

This view he continued to hold after the majority of his brethren had taken a new position.[26] Thus the new doctrine was not undisputed in the *sanctum sanctorum*, and herein lay the prospect of doctrinal mutation.

Still another force, however, had helped to bring order into multiple taxation. The National Tax Association had campaigned steadily for adoption in state statutes of a reciprocity provision by which state A would agree to exempt the intangibles of nonresident decedents (i.e., decedents domiciled in state B), provided that state B would reciprocate.[27] After 1925 the campaign met with a favorable response and by 1932 thirty-nine states coöperated in this plan.[28] Mr. F. S. Edmonds, the chairman of the committee of the Association which had the responsibility for the program, was so sanguine as to announce, "the job is done."

Progress toward state uniformity in matters other than multiple taxation had not been achieved. The Delano committee had hoped and recommended that the states would shift from inheritance to estate taxation because the latter offers decisive advantages in administration. The estate tax can be settled as soon as the value of the total estate is determined; the inheritance tax depends upon the number and relationship of those who are to receive bequests. All the inevitable peculiarities of individual wills hinder determination of the tax and these raise problems which literally are soluble only by compromise. The reason why the states have favored the inheritance tax is that it permits distinctions in rates of tax to be made between different classes of beneficiaries, and a common-sense interpretation of justice has com-

[25] *Blackstone* v. *Miller,* 188 U.S. 189.

[26] E.g., in *Farmer's Loan and Trust Company* v. *Minnesota,* 280 U.S. at 218, he said: "A good deal has to be read into the Fourteenth Amendment to give it any bearing upon this case. The Amendment does not condemn everything that we think undesirable on economic or social grounds." For a survey of the legal history see C. L. B. Loundes, "The Passing of Situs," *Harvard Law Review,* March 1932.

[27] For a history of earlier efforts see Shultz, *Taxation of Inheritance,* pp. 144–48, p. 254. The retaliatory provisions, by which state A taxed the intangibles of nonresident decedents with domicile in state B, if state B so treated decedents of state A, was also used.

[28] *Proceedings of the National Tax Association,* 1932, p. 182.

mended such provisions. What is not appreciated is that this sort of justice can be secured when the estate tax is used and that it may often be defeated by the administrative complexity of the inheritance tax. A testator certainly has it within his power to provide that death taxes be paid out of the residuary estate and if this is done each beneficiary can be left the desired amount. Moreover, an estate tax can be so drawn that the exemptions depend upon the number and the relationship of the beneficiaries,[29] thus achieving the principal advantage of the inheritance over the estate tax.

Finally, adoption by the states of the estate tax would bring them into harmony with federal practice, and while this would be no advantage if there were a prospect of federal withdrawal from the field, it has clear advantages so long as the federal tax remains and particularly so long as the 80 per cent credit is based upon the amount imposed under the federal estate tax of 1926. A state using an inheritance tax cannot possibly adjust the rates so that the tax paid on every particular estate equals 80 per cent of the federal levy, yet, to take less is to deprive the state government of revenue with no advantage to the tax-payer. The obvious remedy would be for a state to shift to an estate tax modeled upon that of the federal government, and by 1932 seven, and by 1939 eight, states had done this (compared with two states in 1925). But most states, following the lead of New York, choose as an easier way the enactment of a *supplementary* estate tax which would absorb the difference between the amount of the state inheritance tax and 80 per cent of the federal tax. By 1932 twenty-seven, and by 1939 thirty-three states, had done this.[30] The supplementary tax usually declared:

> In addition to the inheritance tax imposed by the laws of this state, there is hereby levied and imposed an estate or excise tax upon the transfer at death of the estate of every resident decedent, the amount of which shall be the amount by which 80 per cent of the estate tax payable to the United States Government under the provisions of the Federal revenue act of 1926 and amendments thereto shall exceed the aggregate amount of all estate, inheritance, legacy and succession duties actually payable to the several States of the United States and subdivisions thereof in respect to any prop-

[29] See *Report of the National Committee on Inheritance Taxation*, p. 36.

[30] Joint Committee on Internal Revenue Taxation, *Federal and State Death Taxes*, p. 80. For a fuller classification of types of state taxes see *Federal, State and Local Government Fiscal Relations*, p. 473.

erty owned by such decedent or subject to such taxes as part of or in connection with his estate.[81]

This was, perhaps, a slovenly solution, since the federal credit thus served to introduce a new complexity.[32] And if the rates paid on estates of various size in 1925 to 1939 are compared, it appears that while there has been an increase in rates, the increase has affected mainly the larger estates. (See Table 36.)

TABLE 36

AVERAGE RATE OF STATE TAX ON NET ESTATES PASSING TO A WIDOW, 1925 AND 1939[a]

Size of estate	1925	1939
$ 50,000	1.0%	1.1%
200,000	2.3	2.7
1,000,000	3.7	5.0

[a] Oakes, *op. cit.*, p. 579.

The federal tax until 1932 carried an exemption of $100,000 and net estates under $1,000,000 were subject only to rates running from 1 per cent to 7 per cent. Thus the 80 per cent credit put no pressure upon the states to impose heavier taxes upon the low and middle brackets. It merely held in check the tendency of state death taxes to disintegrate at the top. When in 1932 the federal government, by lowering its exemption to $40,000, proceeded to take for itself a larger slice of smaller as well as larger estates, the states were in no position to protest because it was clear that they had not availed themselves of their opportunities.[33]

[81] Joint Committee on Internal Revenue Taxation, *Federal and State Death Taxes,* p. 81.

[82] Oakes, "The Federal Offset and the American Death Tax System," pp. 577–80.

[88] The effect of the increased federal rates and lowered exemptions of the federal estate tax after 1932, against which no credit applied, was to give no offset on the tax levied on net estates of $100,000 and less, while on estates in excess of $100,000 the offset runs from 8/10 of 1 per cent on the first $40,000 to 16 per cent on the excess of the estate over $10,000,000.

Net estate	Federal rates of 1926	80 per cent credit
Up to $150,000	1%	0.8%
$ 150,000–300,000	2–3	1.6– 2.4
300,000–400,000	4	3.2
400,000–500,000		
500,000–600,000	5	4.0
600,000–800,000	5–6	4.0– 4.8
800,000–1,000,000	6–7	4.8– 5.6
1,000,000–10,000,000	7–19	5.6–15.2
10,000,000 and up	20	16.0

The years after 1926 did not, to be sure, provide an atmosphere in which legislatures could readily levy higher death taxes, but such an excuse for inaction does not satisfy at a time when the states were demanding complete and exclusive power over this source of revenue.

The war taxes have aggravated all these defects. By the 1941 revenue act, the federal tax upon small estates was greatly increased and the opportunity of the states to secure more revenue in this area was narrowed. Some states which permitted deduction of the federal tax in computation of the state tax have already repealed this privilege. The lowering of the federal exemption for the estate tax means also that the levy which the federal government makes on small estates is relatively much larger than that which it makes on larger estates. Only estates over $100,000 receive any benefit from the credit because only such estates were taxed under the estate tax of 1926. This is a completely artificial and illogical situation.

THE CASE AGAINST FEDERAL WITHDRAWAL

None of the arguments urged during the 1920's in support of state preëmption of death taxes now seem to have weight. After more than a quarter century of federal occupancy even the historical plea of state priority has lost meaning. The argument based on relative fiscal need made sense until the war emergency, but it alone would not justify leaving the states with a tax which, administratively, they cannot handle as well as the federal government. There are, moreover, strong economic reasons in favor of federal death taxation. Large estates are now accumulated from nationwide activity and the taxation of them on a national basis is, therefore, desirable. Again, state death taxes are certain to be defective in applying progression. Large estates, comprised mostly of intangibles, are mobile; for this reason each state is afraid to go further than its neighbors and the result has been a scale of rates which has not realized the legitimate possibilities of death taxation. Other more technical factors also hinder proper progression. The state of domicile of a decendent does not tax the real property and the tangible personal property in an estate which is located elsewhere. Yet the rate of progression should be determined by the *total* value of an estate. And what rate should be applied by the state in which the real property and the

tangible personal property is located? This is a part, and probably only a small part, of the total estate. If more than one state taxes the intangibles (or any other property) in an estate, then there is a further aggravation, since thereby any reasonable scale of progression is disturbed. Some of these difficulties in the application of progression could be overcome by adoption of a plan whereby rates would be determined in all cases by the amount of the total estate, rather than by the amount which happens to be within the jurisdiction of a particular state. But this has been little used and it presents many obvious administrative complications.

State death duties also have jurisdictional limitations in reaching such types of property as intangibles, bank deposits, movable personal property, etc., which may be kept outside the limits of a particular state and about which a particular state may have no information. Interstate agreements can overcome this obstacle, but these depend upon a coöperation which cannot always be secured and which is often not attempted.[34] A state may even have difficulty in collecting taxes due it, if the assets of the estate which are within its control are insufficient to cover the tax.[35]

The objections to multiple administration—establishing forty-nine sets of officers for one tax—are important not in themselves but principally because each set operates a tax which is somewhat different from every other. If, by some miracle, uniformity in state death taxes could be achieved, multiple administration would not in itself be disadvantageous. The reason is that complete centralization in the hands of the federal government would pose a difficult task. In the past federal administration of the death tax has been criticized as bureaucratic and slow-moving. Large scale administration requires multiplication of rules, and yet the rules, in the individual case, may hamper a prompt and equitable settlement. In a few states the quality of the officials is excellent, and, since the task is of moderate dimensions, administration has been superior to that at Washington. This fortunate occurrence should not, however, disguise the fact that no

[34] *Conflicting Taxation,* 1935 Progress Report of the Interstate Commission on Conflicting Taxation (Council of State Governments, Chicago, 1935), pp. 103–04.

[35] *Massachusetts* v. *Missouri,* 308 U.S. 1. The decedent died in Massachusetts leaving an estate there of $12,000 and trusts of intangibles (two of them revokable) worth $1,850,000 in Missouri. Massachusetts claimed a tax of $137,000 from the Missouri trustees which the Supreme Court refused to help it collect.

major state tax is "more poorly administered than the death tax, whether judged by principles of organization, by equity of application, or by available quantitative measures." [36]

The prime consideration remains that levy of a death tax by competing jurisdictions makes multiple taxation unavoidable. During a brief stretch of years after 1926, federal credits, legal compulsions, and reciprocity agreements held the evils within narrow limits. But at present the value of the federal credits has been greatly diminished, and the Supreme Court no longer indicates a willingness to outlaw multiple taxation. Some pessimists believe that, as a result, reciprocal agreements will lose their force.

Recent Judicial Decisions

In at least two respects recent decisions of the Supreme Court open the way to multiple taxation. The first concerns double domicile, since by a series of cases concerning the estate of Dr. Dorrance it was established that a decedent might have domicile in more than one state. Dr. Dorrance, who was the sole owner of the stock of the Campbell Soup Company, died in 1929 and both New Jersey and Pennsylvania claimed that he was domiciled in their jurisdiction. The courts of each state upheld the respective claims of their state officers,[37] and a tax of $12,000,000 was paid to New Jersey and one of $14,000,000 to Pennsylvania because the Supreme Court, to which an appeal was taken,[38] refused to intervene. In 1937 the Court again made a similar refusal,[39] declaring that

> conflicting decisions upon the same issues of fact do not necessarily connote judicial action. . . . In any case the constitution of the United States does not guarantee that the decisions of the state courts shall be free from error—or require that pronouncements be consistent. . . . Neither the fourteenth amendment nor the full faith and credit clause requires uniformity in the decisions of the courts of different states as to place of domicile. . . .

Two years later, in a case involving the domicile of Edward H. R. Green,[40] four states claimed jurisdiction and this time the Su-

[36] Heller and Harriss, "The Administration of State Death Taxes," *Iowa Law Review*, March 1941, p. 673.

[37] *Dorrances Estate*, 309 Pa. 151; *In re Dorrance*, 115 N.J. Eq. 268.

[38] 287 U.S. 660 (1932).

[39] *Worcester County Trust Co.* v. *Riley et al.*, 302 U.S. 292.

[40] *Texas* v. *State of Florida*, 306 U.S. 398.

preme Court intervened at the request of Texas "only because the death tax claims of the four states exceeded the total available estate, so that as to the excess there was a real conflict between the states." [41] Such a situation will seldom arise because usually there will be enough to go around. Unless a remedy can be found by the states—and this is unlikely—federal intervention may be needed to secure an equitable adjustment. This seems the more indicated because at least one member of the Supreme Court believes that establishment of a single state of domicile is not an ideal solution for all cases. Justice Frankfurter has said:

> In view of the enormous extent to which intangibles now constitute wealth, and the increasing mobility of men, particularly men of substance, the necessity of a single headquarters for all legal purposes, particularly for purposes of taxation, tends to be a less and less useful fiction. In the setting of modern circumstances the inflexible doctrine of domicile—one man, one home—is in danger of becoming a social anachronism.[42]

Acceptance of this as the law would certainly raise knotty questions concerning division of domicile which the states by themselves could hardly settle. Their experience over a long period of years in allocating corporate income has been most unhappy, with no prospect of ultimate agreement. State disputes over allocation of domicile would be equally frequent and even less soluble.

Much more important has been the recent attitude of the Supreme Court toward multiple taxation of intangibles. In 1939, by two decisions, it moved far away from the position taken earlier in the case of the First National Bank of Boston *v.* Maine. In both cases [43] a decedent domiciled in a given state (A) had created a trust managed by a trustee domiciled in another state (B). State B levied death duties on the ground that the trust had a

[41] Final Report of the Committee of the National Tax Association on Double Domicile in Inheritance Taxation, *Proceedings of the National Tax Association,* 1940, p. 233. The Committee proposed as a remedy that both Congress and the states should designate the federal district court for the District of Columbia as having jurisdiction in death-tax controversies over domicile. To this recommendation a strong minority dissent was registered. *Ibid.*, pp. 248–55. Mark Graves has proposed a scheme by which the states will pass model reciprocal statutes agreeing to make settlement through boards of arbitration. See M. M. Kassell, "Double Domicile in Death Taxation," *Proceedings of the National Association of Tax Administrators,* 1941.

[42] *Texas* v. *Florida,* 306 U.S. at 429.

[43] *Curry* v. *McCanless,* 307 U.S. 357; *Graves* v. *Elliott,* 307 U.S. 383.

situs at the domicile of the trustee; State A, as the domicile of the decedent, also claimed the right to tax. The Court upheld the right of both to tax, with Hughes, McReynolds, Butler, and Roberts dissenting. Clearly the alignment was the Supreme Court of 1939 *v.* the Supreme Court of 1932.[44] The minority of 1939 (the majority of 1932) insisted that multiple taxation is unfair and that no good reason exists why intangibles, as well as tangibles, should not be given a single situs for taxation. The majority of 1939 (the minority of 1932), while agreeing that multiple taxation is unfair, insisted that it is also unfair to ascribe a fictitious situs to intangibles.

> If [said Justice Stone], we enjoyed the freedom of the framers [of the Constitution] it is possible that we might, in the light of experience, devise a more equitable system of taxation than that which they gave us. But we are convinced that this end cannot be attained by the device of ascribing to intangibles in every case a locus for taxation in a single state despite the multiple legal interests to which they give rise and despite the control over them or their transmission by any other state and its legitimate interest in taxing the one or the other.[45]

The Court signalized the new trend in a decision[46] handed down on April 24, 1942, by holding that Utah could impose a death tax on the stock of a Utah corporation owned by a resident of New York. The transfer office and the stock certificates were outside Utah. The majority opinion expressed an awareness of the bad "practical" effect of the decision. It insisted simply that provision of protection against multiple taxation was not within the province of the Court. Justice Frankfurter, in a concurring opinion, went farther and enunciated the theory—the benefit theory—upon which multiple taxation was based.

> Modern enterprise often brings different parts of an organic commercial transaction within the taxing power of more than one state, as well as that of the Nation. It does so because the transaction in its entirety may receive the benefit of more than one government. And the exercise by the States of their Constitutional power to tax may undoubtedly produce difficult political and fiscal situations. But they are inherent in the nature of our federalism and are part of its price. These problems are not peculiar to us. Kindred problems have troubled other constitutional federalisms.[47]

[44] R. J. Traynor, "Tax Decisions of the Supreme Court," *Proceedings of the National Tax Association*, 1939, p. 29.

[45] 307 U.S. at 373.

[46] *State Commissioner of Utah* v. *Aldrich*, 316 U.S. 174

[47] *Ibid.* at 183–84.

Justice Jackson (and Justice Roberts) dissented. If the fiction of the domicile of a natural person was defective, that of the domicile of an artificial person was still more so.[48] The benefit theory could not serve as a basis upon which rules could be built because

> in a very real sense every State and Territory in the Union has conferred very real benefits upon every inhabitant of the Union. . . . All of them have yielded up men to provide government at home and to repel the enemy abroad. I am their very real debtor, but am frank enough to say I hope not a potential taxpayer, of all.[49]

It would, therefore, seem that in the future, as before 1926, multiple taxation of intangibles by death taxes will be avoided only if the states, through agreements or by exempting the intangibles of nonresident decedents, choose to refrain. All the difficulties of the 1920's may be revived and multiplied. As Justice Jackson has said: "One need not be unduly soft-hearted toward taxpayers to doubt whether the exhaustion of estates through multiplication of reports, returns, appraisals, litigation, counsel fees, and expenses ultimately make for a sound fiscal policy or an enlightened social policy." [50]

Schemes for Reform

This brief review appears to point to the conclusion that complete federal administration of death taxes is desirable. As a matter of practical politics, however, nothing of the sort is in sight, and therefore some mention of less radical shifts should be made. One minor modification would be to simplify the rate structure by amalgamating the federal credit with the existing rates of the federal tax. At present the 80 per cent applies only against the rates of the 1926 tax and this necessitates two sets of rates and two different exemptions with a credit allowed for state taxes in the one case and not in the other. Substitution of one

[48] "The older view ascribed a fictional consequence to the domicile of a natural person; it is overruled by ascribing a fictional consequence to the domicile of an artificial corporation. The reason back of the holding is this: Because Utah issued a charter to a corporation, which issued stock to a nonresident, which changed hands at his death, which required a transfer on the corporation's books, which transfer was permitted by Utah law, Utah got jurisdiction to tax succession to the stock. It is really as remote as that." *Ibid.* at 186–87.

[49] *Ibid.* at 200.

[50] *Ibid.* at 195.

rate schedule, with credit given against it, has been suggested.[51] This would be to admit that the additional federal levies since 1932 were no longer to be regarded as temporary.

A more important suggestion is that the credit given to the states—whatever its amount—should be graduated so that a larger percentage credit be given on small than on large estates.[52] The 80 per cent credit operates, of course, in just the opposite way. Small estates receive no credit against the federal tax and the amount of the credit for large estates mounts as the estate grows. It has been estimated that the maximum federal credit as a percentage of the total federal tax, at 1941 rates and exemptions, ran from 1.1 per cent on a net estate of $120,000 to 17.6 per cent on a net estate of $10,000,000.[53] The actual ratio of the credit to the federal estate tax liability for the four years, 1936 to 1939, was 16.6 per cent.[54]

The effect of this might be to push the states—the force of the push depending upon the amount of the credit—toward taxation of small and middle estates, leaving to the federal government the revenue from the larger estates. It is agreed that the larger estates are likely to consist of assets which are national in character. A millionaire, although legally domiciled in one place, will conduct his business over the nation and the bulk of his estate will be in the form of intangibles. The state of domicile should not have a highly favored—even an exclusive—claim to levy death duties. "The taxation of a large estate at the domicile of the owner is similar to the disapproved practice of taxing in the particular district in which the central plant is located, a utility which serves a large area." [55] Thus the argument leads to the conclusion that federal taxation of large estates is the desideratum. Administrative considerations reinforce the argument, since state officers, handling large estates, are hampered by

[51] U.S., 75th Congress, 3rd session, House Hearings before the Ways and Means Committee, Revision of the Revenue Laws, 1938, pp. 66–67. The Special Committee on Intergovernmental Fiscal Relations calculated that "a credit of approximately 11 percent of the 1941 Federal gross tax liability computed against the 1939 tax base would have equaled the 80 percent credit of $53 millions actually allowed for that year." *Federal, State and Local Fiscal Relations,* p. 487.

[52] Fifth Report of the New York State Commission for the Revision of the Tax Laws (Albany, 1935); also *Conflicting Taxation,* pp. 114–18.

[53] *Federal, State and Local Government Fiscal Relations,* p. 487.

[54] *Ibid.,* p. 481.

[55] *Conflicting Taxation,* p. 113.

jurisdictional restrictions, territorial limitations, and the complexity of the task. Conversely, however, smaller estates are likely to consist of localized assets. Against them a state has a natural claim to levy a death tax, and its officers, familiar with local conditions and able to reckon with special peculiarities, can do an effective administrative task.

The Special Committee on Intergovernmental Fiscal Relations has studied this and other pertinent features of the crediting device. Granting that graduation is desirable, how many brackets should be provided? How would the individual states fare under a credit based upon the 1941 estate tax liability? Obviously any scheme to be attractive should offer to as many states as possible the equivalent of their present (or even their prospective) death tax revenues. The Committee concluded that the most satisfactory plan would be

> one which allows a credit for State taxes paid of 50 per cent of Federal tax liability on the amount of the net estate not exceeding $100,000 and 25 per cent on the amount exceeding $100,000, accompanied by a reduction in specific exemption and insurance exemption to a maximum of $20,000 each. Under such a crediting arrangement, the evidence indicates that only the States of North Dakota, Oregon, and Utah might find a tax based on the Federal credit inadequate as a substitute for their current levies. Even North Dakota and Oregon would seem to gain at the lower levels, where most of their estates are likely to be. The rates levied in those States are so far out of line with those of other States that to increase the Federal credit sufficiently to cover them would present all other States with an unnecessarily large increase in death taxes and would result in too great a loss in Federal revenue.[56]

The plan has merit and should be carefully considered. It would serve to increase the stability of state, and the instability of federal, revenues from death duties, since the smaller and middle estates would be the chief foundation of state collections.[57] Stable revenues are more important to the states than to the federal government and this shift would, therefore, be advantageous. And if problems of conflicting jurisdiction are to be resolved, the federal government should insist that "the States must accept a Federal determination of domicile and distribution of those es-

[56] *Federal, State and Local Fiscal Relations,* p. 489. The recommendation is made that at any subsequent change in the federal tax, the credit be "reinstated in terms of the law as amended." *Ibid.,* p. 490.

[57] The effect of the 80 per cent credits has been to increase the cyclical variation in the yield of state levies. Oakes, *op. cit.,* pp. 596–97.

tates which are interstate in character for the purpose of determining the Federal credit to which each estate is entitled." [58]

When the credit clause was introduced, and for years afterwards, it was attacked as federal coercion of the states, and undoubtedly the change outlined above would be a bigger step in the same direction. Federal coercion has its dangers, but the cry of states' rights, captiously raised, should not be allowed to block changes which are in the national interest. Whenever the federal government makes a financial concession to the states—as by the 80 per cent credit—it is justified in attaching conditions which may serve to bring order into our tax structure, because no evidence exists that the fiscal problems of federalism can be solved by leaving the states to their own resources. The states might, for example, be pushed toward substitution of estate for inheritance taxes, and toward a model law. In such ways the recurrence of epidemics of multiple taxation might be moderated, and a rational plan to reconcile the conflicting interests of debtor-creditor states be gradually evolved. If, after a time, the base, definitions, and exemptions of the federal and state death taxes could be made uniform, the states should be given the opportunity of turning over administration of their tax to the federal government. This would not mean uniformity in the *rates* of the states' taxes. Federal administration and collection would present no insuperable difficulties even though the state supplements showed considerable rate variation.

Under no possible circumstances, however, could state death taxes be made equally productive from state to state. The death tax of North Dakota, for example, was in 1937 somewhat more severe than that of Connecticut; yet the former produced a revenue of \$.03 per capita and the latter \$1.89.[59] The states are, and will continue to be, extremely heterogeneous in fiscal resources. Poor states cannot, even by the levy of rates considerably higher than those of their more fortunate neighbors, secure a revenue which is comparable in amount.

The opinion that progress in reform of federal and state death taxes can best be made by use of the crediting device is one of expediency. The device is now in use, and in a federalism this is a major consideration. Yet the ultimate aim with respect to death taxes should be federal administration.

[58] *Federal, State and Local Fiscal Relations,* p. 495.

[59] U.S., 75th Congress, 3rd session, House Hearing before the Ways and Means Committee, Revision of the Revenue Laws, 1938, Exhibit 20, p. 137.

CHAPTER XVI

GOVERNMENT INSTRUMENTALITIES

The power to tax is not the power to destroy while this court sits.

JUSTICE HOLMES.

EXEMPTION OF FEDERAL INSTRUMENTALITIES

THE SINEWY PHRASE of Chief Justice Marshall "that the power to tax involves the power to destroy" [1] is probably the most quoted epigram in tax history. From it stemmed limitations upon the taxing power of both federal and state governments which were of the greatest importance and which now, after the passage of a century, seem in process of being cut away.

The case of M'Culloch *v.* Maryland involved a discriminatory tax levied by the state of Maryland upon the notes of the Second United States Bank, and the great Chief Justice declared in 1819 that the states could not, by taxation or otherwise, burden the operation of agencies created by the general government to carry out its powers. The tax was struck down because it was a tax, and the Court brushed aside the pleas of the state that the tax in fact was light. The very attempt to place a burden on a legitimate federal agency was "itself an abuse." There can be no doubt that Marshall, intent upon strengthening the federal power, meant to enunciate a far-reaching doctrine. The tax, because it was discriminatory, could have been rejected on this ground alone without any generalization about the destructive power of taxation. Maryland had aimed a tax directly at the Second Bank,[2] and that sort of action did endanger the union and would,

[1] *M'Culloch* v. *Maryland,* 4 Wheaton 431. The phrase has recently been described by Justice Frankfurter as a "seductive cliché" and "a rhetorical flourish." *Graves* v. *New York* ex rel. *O'Keefe,* 306 U.S. 466.

[2] Professor C. J. Bullock once commented as follows: "When Chief Justice Marshall said that the power of taxation involved the power to destroy he forged a thunderbolt and hurled it at a mosquito. If taxes are levied for revenue, that thing is absolutely false. Taxes levied for revenue cannot be levied for more than one year, or a few years, on a basis that destroys. Governments have got to let taxable ability and taxable business and the objects of taxation live. It is the power to levy a discriminating tax that destroys, and it was that kind of tax Chief Justice Marshall had before him." *Proceedings of the National Tax Association,* 1921, pp. 491–92.

if tolerated, make the federal government dependent upon the states. But when the Chief Justice declared that state taxes as such involved the power to destroy, he went, for reasons of statesmanship, beyond what the occasion required and beyond correct generalization. His epigram has come echoing down the courtrooms with results not conducive to logical federal–state fiscal relations.[3] Ten years after M'Culloch *v.* Maryland the Supreme Court held (in 1829) that an nondiscriminatory property tax on obligations of the federal government owned by individuals was unconstitutional,[4] and in 1842 a federal officer was declared not subject to a county tax measured by the value of his office.[5]

In these three cases the freedom of federal instrumentalities was expressed quite generally and without significant reservation, and in succeeding years the courts indicated the specific activities which were exempt. Broadly speaking, the states could not tax securities of the federal government and its agencies, salaries attached to federal offices, a federal franchise, a lease of Indian lands, and many other functions.[6] Although in the heyday of the doctrine, the Supreme Court was zealous in protecting the federal functions from state and local taxation, there was always a flexible and shadowy limit beyond which it was not prepared to go. Even in M'Culloch *v.* Maryland the right of Maryland to tax the real property of the Second Bank had been recognized, and many other instances in which state and local taxes did not interfere substantially with the exercise of federal powers might be cited. Moreover, Congress has on occasion provided that its instrumentalities could be taxed in specified ways by state and local governments. National banks provide one notable example.

Although the idea of dual sovereignty would appear on its face to require that state instrumentalities should enjoy the same freedom from federal taxation as federal from state, it was over fifty years before this doctrine was framed by judicial interpretation.

[3] A century later another great jurist, Justice Holmes was to cap the Marshallian epigram with another: "The power to tax is not the power to destroy while this court sits." *Panhandle Oil Co.* v. *Knox,* 277 U.S. 223.

[4] *Weston* v. *City of Charleston,* 2 Peters 449.

[5] *Dobbins* v. *Commissioners of Erie County,* 16 Peters 435.

[6] See T. A. Youngquist, "Constitutional Limitations, Express and Implied, upon the Taxation by the Federal and State Governments, Respectively, of Governmental Agencies and Functions," *Bulletin of the National Tax Association,* November 1932, pp. 57–58, for a convenient list.

Until the Civil War federal taxation was so light and so confined to customs duties, that proper doctrinal instances did not come before the courts. But in 1871, through its decision in the case of Collector *v.* Day,[7] the Supreme Court denied the right of the federal government to tax the salary of a state judicial officer. In the light of history the decision is part of the retreat from the nationalism of the Civil War, and as such it is not in the tradition of Marshall. Indeed, Marshall in delivering the opinion of M'Culloch *v.* Maryland had insisted that its doctrine with respect to the power of the states to tax federal instrumentalities was not reversible. Congress stood for the whole people and the states themselves were represented in it. Congressional taxation was national in scope, and operative over the nation.

> But, when a state taxes the operations of the government of the United States, it acts upon institutions created, not by their own constituents, but by people over whom they claim no control. The difference is that which always exists, and always must exist, between the action of the whole on a part, and the action of a part on a whole—between the laws of a government declared to be supreme, and those of a government which, when in opposition to those laws, is not supreme.[8]

Thus the notion that, in order to preserve a balance in the federal system, the exemption of state instrumentalities from taxation followed from the exemption of federal, would not have secured his endorsement.

The connotations of exemption of state instrumentalities were gradually elaborated by the Supreme Court. In 1895 by the decision of Pollock *v.* Farmers' Loan and Trust Co. it was held that the federal government could not tax the income of securities issued by states and their subdivisions [9]—a decision the converse of Weston *v.* City of Charleston.

It was not long, however, before the Supreme Court introduced an important qualification to the doctrine of state exemption. South Carolina set up a state monopoly in the sale of liquor. Were the agents of the state engaged in this activity subject to license tax as imposed by the internal revenue laws of the federal government? The Court declared in 1905 that they were. The exemption of state agents was limited "to those which are used by

[7] 11 Wallace 113.
[8] 4 Wheaton 435.
[9] 157 U.S. 429.

the State in carrying on of an ordinary private business." [10] It has not been easy to discover a line between governmental and nongovernmental or proprietary functions, but the broad clue which appears to have guided the Supreme Court is whether or not the activity is for the purpose of securing a profit.

The important point is, however, that no similar distinction has been drawn with respect to federal activities. And when Congress has, by statute, given exemption from taxation to various federal agencies, e.g., the Reconstruction Finance Corporation, this has never been questioned by the Supreme Court. The contrast here seems to be clear-cut. The Court has, to be sure, sometimes questioned the decisions of Congress as to what are proper federal functions, and it may, for this reason, declare that certain federal agencies are unconstitutional. But if it decides that the federal agency is constitutional, the consequence seems to follow that the agency is *ipso facto* governmental. In a recent case the Court was very explicit.

> The Federal Government [it declared], is one of delegated powers, and from that it necessarily follows that any constitutional exercise of its delegated powers is governmental. . . . It follows that when Congress constitutionally creates a corporation through which the Federal Government lawfully acts, the activities of such a corporation are governmental. . . .[11]

Let us next consider briefly the exemption of state and local officers. Determination of who is a state officer has called for many administrative rulings by federal officials, and for some court decisions. Obviously state and local officers not engaged in a governmental function have no tax exemption, and equally clearly officers engaged in a governmental function do not have exemption on that part of their income which is received from other activities. But what of persons engaged temporarily to assist in the performance of governmental functions? In the main, they have been held not to be exempt unless their duties,

[10] *South Carolina* v. *United States,* 199 U.S. at 461. In the recent case of *Ohio* v. *Helvering,* 292 U.S. 360 in 1934, the Supreme Court relied upon this earlier decision. The state argued that state liquor stores were a means of exercising its police power, and should, therefore, be tax-exempt. The Court answered that the right to regulate was not the same as the right to undertake. "If a state chooses to go into the business of buying and selling commodities, its right to do so may be conceded so far as the Federal Constitution is concerned; but the exercise of the right is not the performance of a governmental function and must find its support in some authority apart from the police power." *Ibid.* at 369.

[11] *Federal Land Bank of St. Paul* v. *Bismarck Lumber Co.,* 314 U.S. 95.

tenure, and remuneration are prescribed by law.[12] The Supreme Court has held that the income derived by a firm engaged by a state as consulting engineers in connection with installation of water supply and sewage disposal systems was not exempt from federal income tax.[13] These engineers were "independent contractors" engaged in duties defined by contract rather than by law. This decision (made in 1925), and subsequent Treasury rulings issued as a result of it, served to narrow appreciably the scope of the state exemptions which at one time appeared to be opened by the decision of Collector *v.* Day.

Yet it seemed for a time that this narrowing of immunity was drawing the Supreme Court "into a wilderness of fine distinctions." [14] In 1934 it held that an officer of a municipal street railway did not enjoy immunity; in 1937 it decided that the chief engineer of a municipal water supply bureau did.[15] The field of education, which is clearly governmental, provided a whole crop of subtle decisions, a few of which will be noticed. The state of Texas had set aside certain state lands to be used for the benefit of its university. Some of these had been leased to oil companies, and the federal government taxed the income received from the sale of oil and gas produced from these lands. Were the leases state instrumentalities and as such exempt from federal taxation? In 1931 the Supreme Court answered in the negative.[16] Two years later the Court was called upon to decide whether equipment used by a state university was exempt from customs duties. Chief Justice Hughes, speaking for the Court, held that it was not. The right of Congress to regulate foreign commerce was "inclusive and plenary," and even if the tariff was admitted to be a method of taxation, as well as a means of regulating commerce, the exemption of state instrumentalities had "inherent limita-

[12] Employees in a cafeteria operated in connection with the public schools, "clerical assistance employed by clerks of state courts, although paid out of fees collected by such clerks" are not exempt. See A. L. Powell, *National Taxation of State Instrumentalities* (Illinois Studies in the Social Sciences, vol. XX, no. 4, Urbana, 1936), pp. 26–27, for a list.

[13] *Metcalf and Eddy* v. *Mitchell,* 269 U.S. 514.

[14] Roscoe Magill, "The Problem of Intergovernmental Tax Exemptions," *Proceedings of the National Tax Association,* 1937, p. 394.

[15] *Helvering* v. *Powers,* 293 U.S. 214; *Brush* v. *Commissioner,* 300 U.S. 352.

[16] *Group No. 1 Oil Corporation* v. *Bass,* 283 U.S. 279. But in the next year the Court showed uncertainty because it held that federal taxation of income from oil land leased by the state of Oklahoma was invalid.

tions."[17] In 1937 a question arose out of the federal admissions tax. Were the proceeds from athletic contests conducted by colleges and universities, and devoted to educational purposes, taxable? The Supreme Court again answered "yes." The state—Georgia—was engaging in "a business having the incidents of similar enterprises usually prosecuted for private gain."[18]

But the case which most clearly showed the new attitude of the Court was Helvering *v.* Gerhardt,[19] decided in the same term. By it the salaries of the engineers of the Port of New York Authority—a bi-state corporation created by compact between New York and New Jersey—were held liable to federal income tax[20] on the ground that the federal levy was nondiscriminatory and to give immunity would be to limit unduly the federal taxing power. Justice Butler in a dissenting opinion pointed out the revolutionary nature of the decision. "Expressly or *sub silentio* it overrules a century of precedents."

The Court, meanwhile, had acted so as to reduce the immunity of federal officers from state and local taxation. In 1937 a tax imposed by West Virginia upon the gross receipts of an independent contractor for work done for the federal government was upheld.[21] Here also a dissenting opinion insisted that this was to overrule "a century of precedents." Two years later by New York *ex rel.* Graves *v.* O'Keefe,[22] the Supreme Court decided that an officer of the Home Owners' Loan Corporation, a federal wholly-owned corporation, could be subjected to income tax by the state of residence. The Court emphasized that here there was no question of a governmental or nongovernmental activity. Congress had not declared the officers of this corporation to be nontaxable, and therefore the parallelism with the Gerhardt case was clear. "All the reasons for refusing to imply a constitutional prohibition of federal income taxation of salaries of state employ-

[17] *Board of Trustees of the University of Illinois* v. *U.S.*, 289 U.S. 56.

[18] *Allen* v. *Regents of the University System of Georgia*, 304 U.S. 439 at 452. Justice Butler in a dissent said: "It is hard to understand how the collection by the State of fees for the privilege of attendance brings, even for the purpose of federal taxation, its work of education to the level of selling intoxicating liquor" (p. 547).

[19] 304 U.S. 405.

[20] Justice Black in a concurring opinion expressed the view that the Court "should review and reëxamine the rule based upon Collector v. Day."

[21] *James* v. *Dravo Contracting Co.*, 302 U.S. 134.

[22] 306 U.S. 466.

ees, stated at length in the Gerhardt case, are of equal force when immunity is claimed from state income tax on salaries paid by the national government and its agencies."[23] The burden on government was, moreover, not so significant as to justify immunity, and if allowed "it would impose to an inadmissible extent a restriction on the taxing power which the Constitution has reserved to the state governments." Justice Frankfurter signalized this "reversal of a long line of decisions" by a concurring opinion the theme of which was "back to the constitution."

The practical result was that Congress in 1939 passed the Public Salary Tax act which, in effect, codified these decisions.[24] The federal government was in the future to tax salaries of state officers and it made possible state taxation of federal officers.[25] The abolition of this immunity brought clear advantages. It had become very difficult to set the boundary between the exempt and the nonexempt group, and the litigation over it, instead of moving toward some equitable goal, had multiplied the confusions. Besides, any exemption of citizens from taxation is, *prima facie*, an evil, since it sets up a favored group and arouses the irritation of taxpayers. The revenue producing consequence of the step will not, however, be great. Some 2,600,000 state and local employees will be affected, but their salaries are not large[26] and federal taxes on them will not be very productive. The salaries of federal officers run higher, but many of them, living in the District of Columbia, will not be accessible to state and local taxation.

The New Doctrine and Its Dangers

The trend toward curtailment of immunity has caused some foreboding. The theory upon which curtailment has gone is

[23] *Ibid.* at 486.

[24] This act also provided for taxation of the salaries of federal judges who took office on or before June 6, 1932. The revenue act of 1932, and succeeding acts, had provided for taxation of salaries of judges taking office after this date, and this had been upheld by the Supreme Court in 1939 in the case of *O'Malley* v. *Woodrough* which "removed another judicial landmark."

[25] Besides this reciprocal provision for taxation of salaries, there was a special reason for the legislation. The treasury believed that the decision of *Helvering* v. *Gerhardt* would, unless remedial congressional action were taken, force it to collect back income tax for at least three years from employees of many state agencies.

[26] Mr. Hanes, the Undersecretary of the Treasury, estimated that in 1937, 15 per cent of these employees had salaries of $1000 or less, 60 per cent salaries of $1000–$2500, and 25 per cent over $2500 (U.S., 76th Congress, 1st session, Senate Hearings, Committee on Finance, Tax-exempt salaries, p. 10).

that *nondiscriminatory* taxation carries with it no dangers; and the implication is that, if the new freedom given to governments to tax is used in a discriminatory way, the courts as the referees of federalism will come to the rescue. Some there are who doubt that this will be done. Discrimination in taxation is a subtle weapon; the courts have not, in the past, been prompt in detecting its use, and they cannot be expected to do a better job in the future. Of much greater importance is the fact that, apart from the refereeship of the courts, the states are in a position which is inherently weaker than that of the federal government. If, as has been suggested, the doctrine of reciprocal immunity is "presently marked for destruction," [27] there is a broad field in which the states must look for maintenance of reciprocity not to the courts, but to Congress itself. The reason for this has already been indicated. While the states have, the federal government has not, nongovernmental agencies; and Congress may at its discretion declare that its agencies are free from all taxation, or that it will permit state and local taxation within prescribed limits. The immunity of many federal instrumentalities appears to be largely a legislative question. The recent growth in the number of federal agencies underlines the importance of this problem, and one student of constitutional law, fearful that Congress may tilt the balance in its favor with respect to immunity, has proposed a constitutional amendment prohibiting Congressional grant of tax immunity to its agencies and authorizing the levy of a property tax by states and localities against federal property.[28]

The most notable instance in which expansion of federal activities focused attention upon the tax problem was the TVA. The original legislation in 1933 provided that 5 per cent of the gross proceeds received from the sales of power in Alabama and Tennessee was to be given in lieu of taxes in proportion to the amount of power generated in each state. This proved unsatisfactory because generation of power was an unfair basis for distribution, because the in lieu payments went to the state governments which did not relieve the localities and because other states in which TVA acquired property received no payments. In 1940

[27] Justice Butler in a dissenting opinion in the O'Keefe case, 306 U.S. 466 at 493.

[28] R. C. Brown, "Intergovernmental Tax Immunity: Do we need a constitutional amendment?" *University of Washington Law Quarterly*, February 1940. See also D. H. Eldridge, "War and State Sales Taxes," *ibid.*, July 1942, pp. 406–15.

an amendment provided a fairer but more complicated method of distribution. Beginning in the fiscal year 1941 the payments were to be 10 per cent of the gross proceeds, but this figure is to be reduced to 5 per cent by 1948. The basis of distribution is a formula which takes account of sales and value of properties; the local governments are to get a share.[29]

Generalizations concerning the proper basis for in lieu payments are difficult to make. The tax loss to the state and local governments is hard to compute; and in any case the federal government should not by its payments perpetuate the existence of every sort of governmental unit. And what account is to be taken of the great benefits which the federal activities may bring to a whole area?

Some of the states—Alabama and Georgia for instance—aware that inter-governmental immunities are being reduced, have passed laws providing for taxation of federal property, and activities are taxed except where the state is "without constitutional authority to impose such taxes." [30]

The Sixteenth Amendment and Progression in Income Taxation

The most important and the most controversial inter-governmental immunity at present is that on government securities. For many years important attacks have been made against it, most of them instigated by the federal government, and so far without success. On April 25, 1938, President Roosevelt raised the issue once more in a message to Congress. Although by the sixteenth amendment Congress had been given the power "to lay and collect taxes on incomes from whatever source derived," yet the income from state and local bonds had been exempt from federal taxation, and reciprocally federal bonds had been exempt from state and local taxes. There were, the president pointed out, clear evils connected with this immunity, and therefore steps should be taken to remove it.

[29] D. E. Lilienthal, and R. H. Marquis, "The Conduct of Business Enterprises by the Federal Government," *Harvard Law Review*, February 1941, especially pp. 596–601.

[30] C. B. Pond, "The Value and Importance of Exempt Real Estate in the United States," *Taxes*, July 1940. The laws are inoperative at present. See also U.S., 76th Congress, 1st session, House Document No. 111: *Federal Ownership of Real Estate and Its Bearing on State and Local Taxation*.

Let us glance first at the judicial interpretation of the sixteenth amendment. "Most people not lawyers"[31] would assume that by this amendment the federal government had been given the right to tax *all* income. But in the opinion of the Supreme Court the amendment merely removed the constitutional requirement that the income tax, as a direct tax, should be apportioned. And considerable evidence indicates that Congress and the Governors of some states believed this limited purpose to be inherent in the amendment when it was in process of legislation.[32] In 1910 Governor Hughes of New York drew attention to the wording of the amendment, expressing the fear that it might give Congress the power to tax the income from state and local securities. Senators Borah, Root, and Brown, however, declared that this was not intended, and when, after ratification of the amendment, Congress was framing the income tax of 1913, it specifically provided that interest from state and local securities should be exempt. This statutory exemption has been retained to the present.

Curiously enough, the Supreme Court has never passed directly upon this question. The inference from several decisions, that the amendment did not alter the taxable status of state and local securities, long seemed to be clear.[33] But the recent innovations in its decisions roused the hope of many people that here also it might break with precedent, and that legislation which imposed the federal income tax on the interest from state and local securities might be upheld. Both in a fiscal and an economic sense this step would be of greater importance than abolition of inter-governmental immunity concerning salaries.

The major problems arising in recent years out of tax-exempt securities should be associated with the introduction of taxation of income *at progressive rates*, particularly by the federal government. If income were taxed merely proportionally, then exemption of income derived from certain government securities would bring about an increase in the price of these securities equal to the value of the exemption. A government, in such a case, would not be a loser. The higher price, i.e., the lower yield, at which

31 The phrase is that of Justice Holmes.

32 The evidence is not conclusive and a contrary view can be supported. See Hubbard, "The Sixteenth Amendment," 33 *Harvard Law Review* 794 (April 1920).

33 *Brushaber* v. *Union Pacific Railway Co.*, 240 U.S. 1; *Evans* v. *Gore*, 253 U.S. at 261.

it could issue securities would be equivalent to the taxes which it promised to forego. But when the income tax is progressive, then the value of the exemption becomes worth more according to the size of the income which a taxpayer possesses, and this graduated value will not be reflected fully in the price of an issue. The price will, indeed, be somewhat higher, and *all* who buy the exempt securities will pay this higher price. But the saving in tax thus made possible is very unequal, and this inequality opens the possibility of great gains to the purchasers with large incomes.

When, as a result of World War I, the progression in the federal income tax grew steep and the amount of tax-exempts grew larger, agitation for abolition of exemption became earnest. But not for long. In the middle and later 1920's the fervor diminished, and perhaps the least important reason was the manifest opposition to this step by state and local governments. Because of a number of other circumstances the problem appeared to shrink in significance. Progression in the federal income tax had been decreased markedly, thereby diminishing the incentive which the rich might have for purchase of exempts. Again, investigation showed that the actual concentration of exempts in the hands of the wealthy was less than many people had surmised, and that, therefore, the net loss for the federal government was not great.[34] Several factors explained this rather surprising conclusion. For one thing, the outlook in 1926 was for lower and for less progressive tax rates, which meant that the value of tax-exempts to the rich had diminished. For another, it had not been appreciated how many individuals and institutions purchased government securities for reasons which depended only slightly upon the yield. Insurance companies, educational institutions, conservative investors desired these securities because they were governmental, safe, liquid, and stable in value. In short, part of the demand for tax-exempts comes from those to whom the exemption is valueless. There is, moreover, much irrationality in the choice of investments, and, once a choice is made, individuals do not shift promptly from one type to another as circumstances dictate. And finally, many people with large incomes are not *rentiers;* they are active entrepreneurs who prefer to put their

[34] C. O. Hardy, *Tax-exempt Securities and the Surtax* (New York, 1926), especially chapter iv.

capital into corporate stocks because there lies control over business enterprise.

But while there is good evidence that, in the late 1920's, the loss in federal revenue by the existence of tax-exempts was not great, it is wrong to take this to mean that, for other reasons, tax-exempts are not to be condemned.[35] Exemption impairs the income tax as an equitable means of taxation. Some people who receive large incomes will, for a variety of reasons, not place it in tax-exempts. But others, especially the inactive investors, will be attracted to tax-exempts, and this brings about a "gross discrimination within the upper brackets [of income] in favor of coupon clippers and against those actively engaged in business enterprise."[36] Moreover, if the yield of tax-exempt securities is forced down by the existence of some demand from those who buy these securities for reasons of safety, and not at all for the purpose of tax avoidance, they also are forced to take this lower yield. Sometimes the low yield many even persuade investors with relatively low incomes to eschew government securities in favor of more speculative issues—a distortion of investment demand which is most unfortunate.

Reasons of this sort are part of the explanation of the revival of the drive against exempts in recent years. In addition the progression in the federal income tax has been markedly increased and the prospect of lower rates for the future is remote. These factors clearly operate to increase the use of tax-exempts as a means of tax avoidance.

The Conflict of Inter-governmental Interests

It is now desirable to bring more explicitly into the argument the governmental situation in the United States. If the federal government were the only issuer of exempts, then the prompt cessation in their issue would be the only sensible step, since the reduction in the rate of interest at which its securities might be marketed would not compensate for its loss in income tax collections. In fact, however, exempts are issued by states and localities. If, by a miracle, the exemption privileges of federal, state, and local securities vanished overnight, the states and lo-

[35] See the vigorous and logical argument developed by Henry C. Simons, *Personal Income Taxation* (Chicago, 1938), chapter viii.
[36] *Ibid.*, p. 176.

calities would not, while the federal government would, be in a position to secure a net fiscal benefit. The states and localities would in the future have to pay higher interest rates, yet the right to tax interest would be of small value to them because their available methods of taxation would not prove satisfactory in reaching interest. Local governments in particular have narrow powers of taxation, and it must be remembered that of the total gross debt of states and localities together, five-sixths is local. Some thirty-six states do levy income taxes, but their progression is slight. Beyond a doubt, the existing situation, by which a highly progressive federal income tax cannot be applied to income derived from state and local securities, operates as a subsidy to state and local issues—a subsidy, let it be noted, which accrues in proportion to the amount of borrowing done by a particular government. On the other hand, abolition of exemption would be a fiscal benefit to the federal government. Even if it had to pay some increase in interest rates on its future loans, this would be more than offset by greater income tax collections. The extreme assumption made above—that exemption disappeared—can be dropped without altering our main conclusions.

The modest proposal that only *future* issues of government securities of all sorts be made subject to reciprocal nondiscriminatory taxation has often been advanced. It is obvious why the states and localities cannot be expected to look upon it with approval. Here, then, is an instance in which the existence of a federal form of government, coupled with a quirk in constitutional law, tends to block effective action in the national interest. Exemption was created by judicial interpretation to protect one level of government from adverse action by another. That it then was necessary need not now be argued; that for decades it did no harm is certain. But the rise of the doctrine that taxes should be based upon ability to pay and its practical expression in a progressive federal income tax have made a constitutional change eminently desirable.

The Recent Agitation—Removal of Exemption on New Issues

The Congressional Hearings which rose out of President Roosevelt's message about exemption in the spring of 1938 brought out

the complexity of the problem and the practical difficulties in the way of reform. Witnesses on behalf of the states and localities made a powerful assault both upon the constitutionality and the fiscal wisdom of any step toward abolition of exemption, while federal officers counter-attacked.[37]

Little more need be said here concerning the constitutional position of tax-exempts. It was not difficult to build up an argument in constitutional law for removal of exemption, but doubt remained as to whether this was likely to become the constitutional law expounded by the Supreme Court. Federal officers, confident that the views of the Court had swung away from precedent, argued for legislation removing the exemption on future issues (present federal revenue acts contain an exemption of interest on state and local securities) in order that a test case could be brought before the Court. The states and localities insisted that this would be an improper course. To confront the Supreme Court with a statute was to indicate Congressional endorsement of a plan; it was to foist upon the Court the job of making a decision which should rest with the people. The wise procedure would be constitutional amendment.

In the fiscal argument concerning exemption, attention was centered upon its application only to *future* new issues.[38] This would mean that the supply of exempts outstanding would diminish only slowly, and that the prospective revenue gains and increase in interest costs would accrue little by little. The statistical estimates made both by advocates and opponents ordinarily have assumed a future year in which the plan is in full operation, i.e., when tax-exempts would no longer exist. The estimates of gains and losses for the various levels of government were very diverse.[39] Some of these estimates had an obvious bias, but even

[37] U.S., 76th Congress, 1st session, Senate Hearings before the Special Committee on Taxation of Government Securities and Salaries (this contains a report by H. L. Lutz, "Fiscal and Economic Aspects of Taxation of Public Securities"); U.S. Department of Justice, *Taxation of Government Bondholders and Salaries* (1938).

[38] Refunding issues, made to take advantage of low interest rates, might also be exempt so long as the final maturity date did not exceed that of the original bonds. U.S., 76th Congress, 3rd session, Senate Report 2140, Part 1, of the Special Committee on Taxation of Governmental Securities and Salaries, p. 16.

[39] The treasury estimated that the net gain to the federal government, based upon the tax rates of 1937, would be between $150,000,000 and $300,000,000 a year. It reckoned the annual interest cost to states and localities would increase from $40,000,000 to $105,000,000, without making an estimate of the increased revenue

with the utmost impartiality no conclusive quantitative results can be reached. Consider, for example, the basic question as to what increase in interest rates might be anticipated on future state and local issues. The present spread between the best municipal bonds and the best corporate bonds can be measured, but there will be no agreement over how much of the spread is attributable to exemption. *Some* spread would probably remain regardless of the exemption. And how measure the revenue which the federal government would secure by taxation of state and local bond interest? Assuming that the only change is a conversion of exempts into nonexempts, this estimate requires a knowledge of the distribution of the holdings among governments, corporations, and individuals in order that the appropriate rate of tax can be applied. One is, as a result, forced into considerable reliance upon a priori intellectual argument, although such an argument can be supported by quantitative evidence of limited scope.

TABLE 37

ESTIMATED DISTRIBUTION OF TAX-EXEMPT SECURITIES BY CLASSES OF HOLDERS, JUNE 30, 1937[a]

Holders of securities	Amounts held, in billions of dollars
Governments, their agencies, trust funds, sinking funds, etc.	15.1
Banks, including mutual savings banks	20.9
Insurance companies and other corporations	9.6
Other exempt institutions	1.0
Individuals	19.0
	65.6

[a] U.S., 76th Congress, 1st session, House Hearings before the Committee on Ways and Means Tax-exempt securities, p. 29.

It is, for instance, clear that, in 1937 as in 1925, a large amount of tax-exempts were being held by institutions and individuals with no motive of tax-avoidance. Of the $65,600,000,000 wholly and partially exempt securities outstanding on June 30, 1937, only $19,000,000,000 (29 per cent) was in the hands of individuals (this was 38 per cent of the amount available for investment to the public). Government securities as investments have

which these governments might expect. State and local officers, however, estimated the additional annual costs that would accrue to their governments as $113,000,000, offset merely by increased revenue collections of $17,000,000.

attractions other than as a means of tax avoidance. Yet it is also clear that they *are* used for tax avoidance. Of the $19,000,000,000 in the hands of individuals, $12,363,000,000 was estimated to be held by individuals with incomes of $5,000 or over, and although there is no accurate way of distributing the holdings according to income brackets, other evidence shows that some recipients of large incomes have been attracted to tax-exempts. The treasury made an analysis of the cases of twenty-five persons reporting net income in 1937 in excess of $1,000,000 and it discovered that they reported almost $7,000,000 of wholly tax-exempt interest. As a group they had "one-third more net income after paying their income taxes than they would have had if the tax-exempt securities had been subject to taxation." [40] In these instances there was marked tax avoidance and nullification of the progression in the income tax. But income tax statistics concerning exempts are unsatisfactory, since income from them is not required to be reported. Much more reliance can be placed upon figures concerning estates of decedents, and here the evidence of tax avoidance through purchase of exempts is emphatic. In 1927 state and local bonds (federal were not included) accounted for only 6 per cent of the assets of estates of $1,000,000 and over; in 1932 this had grown to 13.3 per cent and in 1934 to 24 per cent. Holdings of exempts vary directly with the size of the estate as the figures in Table 38 show:

TABLE 38

PERCENTAGE OF GROSS ESTATE CONSISTING OF WHOLLY EXEMPT GOVERNMENT SECURITIES, 1938 AND 1939[a]

Size of net estate before exemption	Percentage 1938	1939
$ 100,000– 200,000	3.5	3.7
200,000– 300,000	5.5	5.2
300,000– 500,000	6.5	9.5
500,000–1,100,000	10.5	15.4
1,100,000–2,600,000	13.9	15.9
2,600,000–5,100,000	14.4	23.5
5,100,000 and over	44.6	38.2

[a] Senate Report 2140, Part 1, p. 18; *Proceedings of the National Tax Association*, 1941, p. 197.

These are average percentages, but they bring out the relative concentration of exempts in the large estates. It is undeniable

[40] U.S., 76th Congress, 1st session, House Hearings before the Committee on Ways and Means, Tax-exempt securities, p. 29.

that the rich have found here a tax-haven. Looking to the future with no prospect of a reduction in the scale or application of progression, and with every prospect of an increase in the volume of exempts, the case is likely to become worse.

Yet it is clear that reform is very difficult because almost all the federal proposals so far submitted appear to the states and localities to lack a "real mutuality." [41] Abolition of exemption of future issues of securities of all governments—and therefore ultimate abolition of all exempts—would not offer real fiscal uniformity because the gains would accrue to the federal government and the losses to the states and localities. It is, of course, open to the federal government to eliminate the exemption privilege from its own issues, and recently it has moved in this direction.[42] As of June 30, 1940, $12,925,000,000 of its securities and of securities guaranteed by it were wholly exempt from federal income tax, but of these $5,997,000,000 were held as governmental funds; $35,013,000,000 were exempt only from the normal tax and $4,916,000,000 of these were held by governmental funds.[43] One may ask why the federal government should deprive itself of any benefit in lower interest rates which would come from exemption. The answer lies in the gain derived from use of a highly progressive income tax which the federal government has and the states have not. And even though states with income taxes would secure some revenue from the right to tax federal issues, they would gain unequally because of the different concentration of holdings within their borders and accessible to them. States without income tax, and all local governments, stand to gain little in revenue from the right to tax federal issues, while exposure of their own future issues to federal taxation would bring an immediate increase in interest costs. One set of circumstances may alter this situation. In recent years state and local debt has been nearly stationary in amount, but the federal debt has increased rapidly. Continuance of these trends would make reciprocal abolition of exemption more attractive at least to some states.

The states and localities have another major objection to the

[41] Senate Report 2140, Part 1, p. 8.

[42] On February 28, 1941, Congress removed the exemption of future federal issues from federal income taxes. If this policy is maintained almost all federal exempts will be eliminated by 1946.

[43] Annual Report of the Secretary of the Treasury for the Fiscal Year ending June 30, 1940, p. 812.

proposal of reciprocal abolition of exemption by statutory declaration. A subsequent Congress might withdraw this declaration, arguing that a state tax is a burden upon the federal government. As Senators Austin and Burke have pointed out:

> A statutory permission to the States to tax the income on Federal bonds could be repealed by any subsequent Congress. But if the Federal Government taxed the States it would be pursuant to an alleged constitutional right which could continue even after the repeal of the permission of the States to tax Federal income. There is no one who would not condemn the injustice of Federal taxation of State securities without reciprocal taxation of Federal securities. But this Congress has no power to commit its successors to policy. If we support a Federal constitutional right to tax the States and give only a permissive statutory right to tax Federal securities, we shall have surrendered the States to the absolute power of the Federal Government.[44]

This is, of course, to assume that the Supreme Court would decide that there is no constitutional impediment to a federal tax upon state bonds and that there is such an impediment to a state tax on federal bonds. Even if the right of the states to tax federal securities rested upon Congressional suffrance, it should not be assumed that Congress is likely to treat the states unfairly. State and local interests are adequately represented in Congress—as federal are not in a state legislature—and if a fair reciprocity in this matter could once be established, a realistic appraisal indicates that it would be maintained.

Yet the states and localities, whether for fiscal or for constitutional reasons, are vehemently and unequivocally opposed to change in the *status quo*. A formidable number of their officers appeared before the Congressional committees in 1939 to express their views. Mr. LaGuardia, as Mayor of New York City and President of the United States Conference of Mayors, declared that, although he was not "property-minded," to do away with exemption would be a serious blow to every city and would disturb the whole financial arrangement of the nation.[45]

However one may deprecate extreme statements about the consequences of abolition, the fact is that the states and localities have a genuine case. Tax-exempts are unfortunate; they are an evil relic of a twist in constitutional law, designed to strengthen the federal power, which now serves to bonus state and local borrowing and to impair the productivity and the equity of our tax system. The national interest demands abolition of tax-exempts,

[44] Senate Report 2140, Part 2, p. 32.
[45] House Hearings, Tax-exempt Securities, pp. 309–11.

and the states and localities should not cling at all costs to their vested rights. On the other hand the federal government should not demand from them an unfair financial sacrifice. The extra revenue which they would have to raise as a result of increased interest charges must come largely from regressive taxes, and this distortion in the fiscal system should be set against the improvement which would result from a federal income tax levied upon *all* income. To aggravate the fiscal position of the states and localities for the sake of an end, desirable in itself, would be to diminish the net gain to the nation.

For reasons such as these it is regrettable that more attention has not been given to framing a proposal for abolition of exemption which would operate fairly as between the different levels of government—which would conform to the existence of federalism. Suggestions have, indeed, been made. Thus Mr. Hanes, the Undersecretary of the Treasury, said before the House Committee on Ways and Means: "If Congress feels that the subsidy which states and localities now enjoy [from issue of tax-exempts] should be continued in some form, it may be accorded directly without producing the great inequities and the highly undesirable effects on enterprise which result from the issuance of tax-exempt securities."[46] But no step was taken to investigate what might be done. The large number and variety of local governments, and the many types of governmental securities, would make impossible any precise or detailed measurement of the alternative subsidy. What should be aimed at is some sort of rough justice, possibly by a federal promise to absorb, for a specified time, interest charges equal to one-half to three-fourths of 1 per cent on new taxable issues of state and local securities.[47] Certainly some scheme on the basis of a reasonable *quid pro quo* could be worked out if the will is there.[48]

[46] *Ibid.*, p. 9.

[47] Professor L. H. Seltzer has suggested that the federal government "agree to make annual or semi-annual payments for a stipulated number of years to all state and local governments in amounts equal to 15 per cent or thereabouts of their interest charges on all fully taxable obligations that they come to have outstanding. This method of compensation can most nearly approximate the amount and distribution of the disguised subsidy of tax immunity that has so far been provided; and it avoids the necessity for special treatment of governmental units whose interest charges are atypically low or high." "Possibilities of Speeding the Elimination of Tax-exempt Securities," *Proceedings of the National Tax Association*, 1941, p. 194.

[48] If at any time in the near future a general over-hauling of federal–state fiscal relations was in prospect, then this problem should be weighed along with others, and there might be no need for a one-to-one offset.

Removal of Exemption from all Issues

A few people, deeply impressed by the evils of tax-exempts, have suggested a more sweeping reform. Any scheme which applies only to future issues will leave outstanding the existing volume of tax-exempts, subject to gradual reduction with the passage of years. Professor Simons has proposed that the federal government secure immediate abolition of all exempts "by federal payment to holders of securities previously exempt of enough additional interest (say 1 per cent at most) to prevent any decline in the value of such property on account of the removal of the exemption." [49] Professor Seltzer has proposed that state and local governments be promised federal subsidies if they would speed up their refunding of outstanding tax-exempts. The subsidies would be spent to induce investors to make voluntary exchanges of their holdings in advance of maturity. At the same time Congress should declare that transfer of exempts from the hands of those who held them when the subsidy legislation was passed would remove the tax immunity. Present holders could thus retain their exempts until maturity; liquidation, either by sale or by exchange for taxable securities,[50] would mean loss of the immunity.

A more extreme proposal is that the federal government sidestep all the problems discussed above by the levy of an excise on the receipt of income from federal, state, and local securities. At first sight this would seem to face obvious legal barriers, but these would, it is hoped, be circumvented by using the distinction, created by the Supreme Court, between the "subject" and the "measure" of a tax. The excise would be levied not against the income, but on the act of receiving the income.[51] The attitude of the Supreme Court toward such a scheme can hardly be predicted. It should, however, be noticed that not only would this put upon the states and localities the burden of higher interest rates, but it would also strike at present holders of exempts. A privilege for which they had paid would be wholly or partially removed, regardless of whether or not they had purchased for the purpose of tax avoidance.

[49] Henry C. Simons, *Personal Income Taxation,* p. 183.

[50] Seltzer, in *Proceedings of the National Tax Association,* 1941, pp. 194–97.

[51] W. J. Shultz, *Principles of Public Finance* (New York, 1938), p. 622; U.S., 76th Congress, 1st session, Hearings, Special Senate Committee, Taxation of Governmental Securities and Salaries, p. 539.

In early 1942 the treasury decided to go beyond its earlier position and to ask Congress to remove the exemption from federal income tax of the interest on outstanding state and local securities.[52] The major justification for this recommendation was the war which, Secretary Morgenthau declared, made unacceptable the gradual elimination of exemption by taxing only future issues.[53] The large increase in income tax rates, imposed and in prospect, operated to give windfall benefits to holders of exempts and to stimulate tax avoidance by purchase of exempts. The annual revenue loss to the federal government from the exemption of state and local issues [54] was estimated at $275,000,000 under the rates proposed by the treasury at this time, and it was argued that the loss might well increase through shifting of outstanding issues (amounting to $20,000,000,000) from the possession of holders deriving no benefit from the exemption to individuals in high-income groups. The treasury admitted that the removal of the exemption privilege would "increase interest rates on new state and local issues by something less than one-half of 1 per cent on the average," [55] with the result that interest costs (supposing the total of debt to be unchanged) would rise by $100,000,000 a year. But it pointed out that this increase would come only as outstanding issues were replaced by new issues and that "it would be 1970 before 90 per cent of the outstanding state and local obligations have matured." Moreover, the treasury took the position that Congress should consent to state and local taxation of the interest on new federal securities,[56] and this reciprocation would reduce the net cost to the states and localities below $100,000,000.

Concerning the constitutional questions the treasury professed to see evidence in recent Supreme Court decisions—particularly Alabama *v.* King and Boozer [57]—for its new recommendation. It insisted that this long-standing exemption, like any other statu-

[52] The first public indication of the new position was in a speech of Mr. Morgenthau on January 24.

[53] U.S., 77th Congress, 2nd session, House Hearings, Ways and Means Committee, Revenue Revision of 1942, p. 8.

[54] Removal of the exemption on outstanding federal tax-exempts was, of course, not proposed.

[55] U.S., 77th Congress, 2nd session, House Hearings, Ways and Means Committee, Revenue Revision of 1942, p. 3083.

[56] *Ibid.*, p. 3127, p. 3083.

[57] 314 U.S. 1.

tory exemption, was "simply an expression of legislative policy" [58] and therefore subject to change. The federal government had not contracted to exempt the income from state and local issues, and to allege that the present recommendation would involve breach of contract was idle. Many investors had, beyond a doubt, "expected a continued tax-free yield when they purchased the obligations"; [59] but that expectation, like others, might be disappointed. And certainly most purchasers of exempts had not, when they bought, anticipated the high tax rates occasioned by the emergency.

Against this bold frontal assault state and local officers rallied vigorously and to good practical effect. The old arguments—good and bad—were paraded, with a natural tendency to insist that the question at stake was the fiscal independence of state and local governments. Congress gave the treasury proposal short shrift, and the prospects are that elimination of tax-exempts will await federal sponsorship of some plan which compensates states and localities for the loss of their well-established privilege.

[58] U.S., 77th Congress, 2nd session, House Hearings, Ways and Means Committee, Revenue Revision of 1942, p. 3085.

[59] *Ibid.*, p. 3086.

CHAPTER XVII

CONCLUSION

IN THIS LAST CHAPTER an attempt is made to bring together and resolve some of the problems of federal–state fiscal relations which have been uncovered by the historical analysis of the preceding pages. It is of the essence of federalism that no complete theoretical solution can be found. Indications can be given, however, of the directions in which solutions may be sought.

The following is a summary of the successive steps in the argument:

1. At the outset an abstract model of an expenditure–revenue relationship is presented under simple, clear-cut, and unrealistic assumptions. This is called the "ideal" or unitary equilibrium.

2. The various impediments to an equilibrium in a federal country—constitutional rigidity and regional heterogeneity—are examined.

3. As a remedy for the expenditure–revenue disequilibrium of a federal country, the device of grants in aid has been utilized. Unless used with care, such grants, even in their simplest (i.e., unconditional) form, may aggravate the initial situation.

4. Grants may, however, be given in the conditional, rather than the unconditional, form. Arguments can be advanced to support both types of grants, and it is not easy to decide in what direction the balance of advantage lies.

5. The weightier considerations, however, seem to favor development of the conditional type of grant, especially when it is recognized that the aim is to establish a *minimum* standard throughout the nation for essential governmental services, and that groups of services should be placed in related series rather than particularized.

6. Such a pattern could be developed if conditional grants were provided on a variable, rather than on a constant, ratio basis. The variation should be according to per capita state income payments, although a wide range of ratios would be undesirable.

7. The actual pattern of existing federal grants in relation to per capita income and the incidence of federal taxation is examined for the United States. The evidence is that the rich states bear a relatively large and the poor states a relatively small share of federal taxation, although some rich states also receive relatively large and some poor states relatively small grants in aid.

8. Revision of existing federal grants is therefore indicated. But custom and law with respect to many of these are so firmly established that practical reform will have to be limited to piecemeal revisions. The public-assistance grants should, however, be placed on a variable basis as the Social Security Board has suggested. Moreover, new grants for education and public health are in prospect, and they should be framed on a basis which will improve the over-all pattern. It is possible also that a thoroughgoing revision of the entire grant system might find a place for a moderate use of the unconditional grant.

9. A redistribution of sources of revenue so as to reduce federal–state tax conflicts calls for complete federal assumption of income taxation. Death taxation can, however, be reformed by use of the crediting device. General commodity taxation should be left with the states, while taxation of particular commodities can be improved by coöperative action.

1. The "Ideal" Revenue–Expenditure Equilibrium

"If a community were literally a unitary being, with a government as its brain, [governmental] expenditure should be pushed in all directions up to the point at which the satisfaction obtained from the last shilling expended is equal to the satisfaction lost in respect of the last shilling called up on government service." [1] The margin is to be thought of as a boundary of irregular shape cutting every sort of expenditure and revenue. The government would extend its fields of expenditure and its collection of revenue in many directions along two sets of boundaries. The intersection would indicate the position of equilibrium between the marginal social sacrifice (as measured by collection of revenue) and the marginal social benefit (as measured by expenditure).

This sort of presentation of the public economy is artificially simple, but it does serve to explain the process in terms of rational

[1] A. C. Pigou, *A Study in Public Finance* (London, 1928), p. 50.

economic planning. It assumes, among other things, that the public economy "will undertake at minimum cost, the production of those goods and services only in the supply of which it has an efficiency advantage over private enterprize," and that "the relative importance of alternative public outlays and the relative importance of alternative public and private outlays can be determined." [2] In such an ideally unitary country the government, aiming at maximizing the national welfare, will have to make some judgments about the proper *level* for each service, the amount of and the method by which revenue is to be raised. Different methods of finance will be appropriate to different types of services. In almost all types of governmental service there is some element of "collective" benefit, but a distinction can be drawn between those which are almost wholly of a collective nature—defense, for instance—in that all classes in the community indistinguishably are affected, and those in which a particular benefit to individuals, cutting across or even overriding the collective benefit, can be detected.

In this simplified model it is not necessary to assume that all governmental functions and revenues are handled by the central government. Certain functions and certain revenues may be handled by local governments not because of any defect in the constitutional power of the central government, but for the sake of administrative efficiency. It must, however, be assumed that these local governments are homogeneous with respect to the level and distribution of wealth of their inhabitants. In such a unitary community it is certain that the principle of administrative efficiency, which leads to delegation of some functions and some sources of revenue to local hands, will leave the local governments with unbalanced budgets. The sources of revenue which they can handle effectively will not be adequate to cover their expenditures. The deficiency will naturally be made up by subsidies from the central government to the localities.

In the circumstances assumed it is easy to find an objective basis upon which to distribute the subsidies. The subsidies will be like a shared tax of which some predetermined amount went to the localities. An even more important conclusion is that the subsidies should be unconditional. The central government has,

[2] R. A. Musgrave, "The Voluntary Exchange Theory of Public Economy," *Quarterly Journal of Economics*, February 1939, pp. 232–33.

of course, an interest in the efficient performance of the functions which it has delegated, but by assumption these functions are best handled by the localities, and conditions imposed from above would be an unnecessary intrusion of bureaucracy. Moreover, the subsidies will not lead to inter-area transfers. There will be transfers from rich to poor within an area and within the community, depending upon the progressivity of the taxes used by the central government. But each area—each locality—will be receiving subsidies raised by the intervention of the central government from it own citizens. In short, the doctrine of financial responsibility, which means that a government should raise and spend its own revenue, is not infringed.

In this simplified model of a unitary community the possibility of achieving an ideal equilibrium of total governmental expenditure and revenue can be outlined. The basis of the model is homogeneity of economic resources among the areas which comprise the whole, and a resultant avoidance of inter-area fiscal transfers. The central government is in a position to appraise the needs of citizens for all governmental services and to see that these are provided not merely by its own officers, but also by the subordinate governments.

As a final step in this simplified scheme, let us assume that the community is "federal" in government, that the homogeneous areas within the nation are "states," and that these states have governmental functions and revenues assigned to them on the basis of administrative efficiency. All of the argument given above is, of course, applicable. The homogeneity of the states (and of the nation) would in itself make for maintenance of uniform governmental services everywhere. State freedom of action would be "natural," and the frictions of bureaucratic controls would not develop.

The scheme has now become so tenuous that it should be brought back to reality. Everyone knows that the states in a federalism are *not* homogeneous one with another. They differ in resources and in occupational interests; some are richer and some are poorer. The division of functions and revenues between them and the national government is not according to administrative efficiency. It is, to be sure, also true that no unitary country is homogeneous in the ideal sense assumed above. But the divergence of a country like Great Britain from this artificial pattern

is by no means as great as that of countries like the United States, or Canada, or Australia. It is, besides, of the essence of a federalism that economic heterogeneity is reinforced by constitutional-political provisions. A basic assumption of federalism is that the states have *some* quasi-sovereign powers. In respect to some things each state is to count as *one*.[3]

2. Equilibrium in a Federal Country

(*a*) *The Constitutional Impediment*

The most obvious impediment to equilibrium in the revenue-expenditure relationship of a federal country is the constitutional limitation upon the power of government to act. In a unitary country the national government can tax and spend as it pleases, subject only to the will of the majority of its citizens. Certain powers may be delegated to local governments, but, as we have seen, this does not destroy the usefulness of the analogy of a community as a unitary being with the government as its brain. In a federal country, however, the states exist as another layer of government for which broad spheres of action are marked out, secured by constitutional provision, and guarded by the courts.

[3] The problems in political science raised by federalism have received wide attention, while those raised in public finance have not. A considerable reading has, however, failed to uncover discussion of one very intriguing political generalization. Can the premise of democratic countries, that the majority should rule (through its representatives), find complete expression only in a nation which is ideally unitary? In such a country, differences of opinion will exist along class lines, or along lines of economic interest, or some other. But the lines of conflict are not likely also to be significantly geographical. The voters who are in the majority (51 per cent) and minority (49 per cent) should be spread fairly evenly over the face of the nation without sharp geographical concentrations.

It is otherwise in a federal country. There, in addition to the other foundations upon which differences in opinion may be built, will arise geographical concentration of majority and minority groups. And this means that, whereas in a unitary country simple majority control may be enough to secure effective governmental action, in a federal country an equivalent control is unlikely to be achieved unless there is, in addition to an over-all total majority, a majority in every major geographical area. It means—neglecting altogether any constitutional restrictions and assuming only political limitations—a check upon the power of the national government in a federalism. Every legislative proposal will be subjected to a geographical scrutiny, and the outcome may be either that national action is confined within narrow bounds, or, if national action is more widely extended, that sectional judgments are often decisive and projects are approved by a process of log-rolling even though some of them, if viewed as units, would not have been acceptable.

Governmental action which seems to promise a net national benefit may be blocked because the federal government has not the constitutional power over certain fields, while certain states, which have the power, may lack the fiscal means.

This division of sovereignty between federal government and states is not artificial. Without it most federal nations would never have been formed, and if formed, they could never have lasted. But however wisely the original division may have been made, it is bound to need modification with the passage of time, and yet modification is likely to be difficult because the constitutional barrier blocks the way. In many modern federations there has come to be a maladjustment between governmental functions and sources of revenue. The states have under their control many functions which have grown in relative importance, while the revenues at their command which they can efficiently handle are inadequate. And the maladjustment is not merely one between the national government, on the one hand, and the states on the other. The states are extremely diverse in fiscal strength; they have often hamstrung themselves and their local governments by self-imposed constitutional limitations upon their freedom of action; and the individual balances which they strike between revenue and expenditure are at very different levels of equilibrium.

It should be stressed that this sort of difficulty is inherent in federalism and is not to be blamed solely on constitutional rigidity. When the scope of governmental functions is being enlarged by reason of a change in social and political philosophy, economic developments, or the impact of war and depression, then this rigidity does aggravate the situation. But, if a federal constitution could be entirely remade so as to put in the hands of the federal government those functions and revenues which it could best handle, and in the hands of the states those which, by administrative criteria, properly belonged to them, there would certainly be a lack of balance between functions and revenue. No natural coincidence exists between the ability of a government to handle a set of functions and its ability to collect revenues. A separation of sources of revenue cannot long be maintained in a federal country, and in most cases it proves unworkable at the outset.

(*b*) *The Impediment of Regional Heterogeneity*

Even when the constitutional power of the national government to act is undeniable, effective action may be hindered by the lack of a clearly defined national interest in many policies. The state governments, and also the representatives from the states in the national legislature, have tended to appraise every national policy in terms of its effect on their particular state. The extreme form of this doctrine demands that national policies, including therein collection of revenue and disbursement of expenditure, should bring equal benefits and burdens to each state. In such a doctrine national policy is to be appraised, not by its effect upon the nation, but by its effect on segments of the nation. The result may be that a piece of legislation which is clearly of advantage to the nation as a whole may fail of enactment because of sectional opposition. One obvious remedy can be—and has been—applied in particular cases: this is to bring forward another piece of legislation which distributes benefits and burdens in such a way as to be compensatory. The dangers of compensatory action of this sort are both obvious and real. In a crude form tactics of log-rolling and back-scratching are involved, and every federal country has suffered from this sort of perversion. In so far as the price of enactment of a measure which is in the national interest is parallel enactment of one which is not, the national gain is whittled down or even obliterated.

It must be emphasized that this situation, unsatisfactory as it may be in terms of ideal unitary finance, is an unavoidable feature of federalism. It is another reason why an expenditure–revenue equilibrium is impossible in a federal nation. The best that can be hoped for is that fiscal policies which are merely compensatory may not be pushed too far and may not bulk too large in the total program. If a federal country were so heterogeneous that every major policy was compensatory rather than national, then the federation would be on the road to destruction.

3. Grants in Aid as a Remedy

Obscurely and in a fumbling manner, Canada and Australia have attempted to remedy the disequilibrium which was found to exist in their expenditure–revenue relationship by use of grants in aid. By historical accident the origin of grants in these countries

was associated with the federal tariff, always a source of sectional (and not merely class) friction in federal countries.

The association arose because at the time of federation, in Canada in 1867 and in Australia in 1901, it was clear to the constitution makers that the federal revenue would be derived chiefly from customs, and that some states[4] would not have adequate revenues to cover the functions which were being assigned to them. With some reluctance both constitutions provided for unconditional grants from the federal treasury, and in both cases distribution was based upon population. This basis was, of course, consistent with the political premise that a federation is a union of sovereign states of equal status—and it would, as indicated earlier, be a proper basis for the distribution of grants in an ideally unitary country. What was not perceived—or not appreciated—was the fact that, since some states were heavier importers than others, the customs duties would bring about an inter-area transfer of revenue; and that the grants were not compensatory.

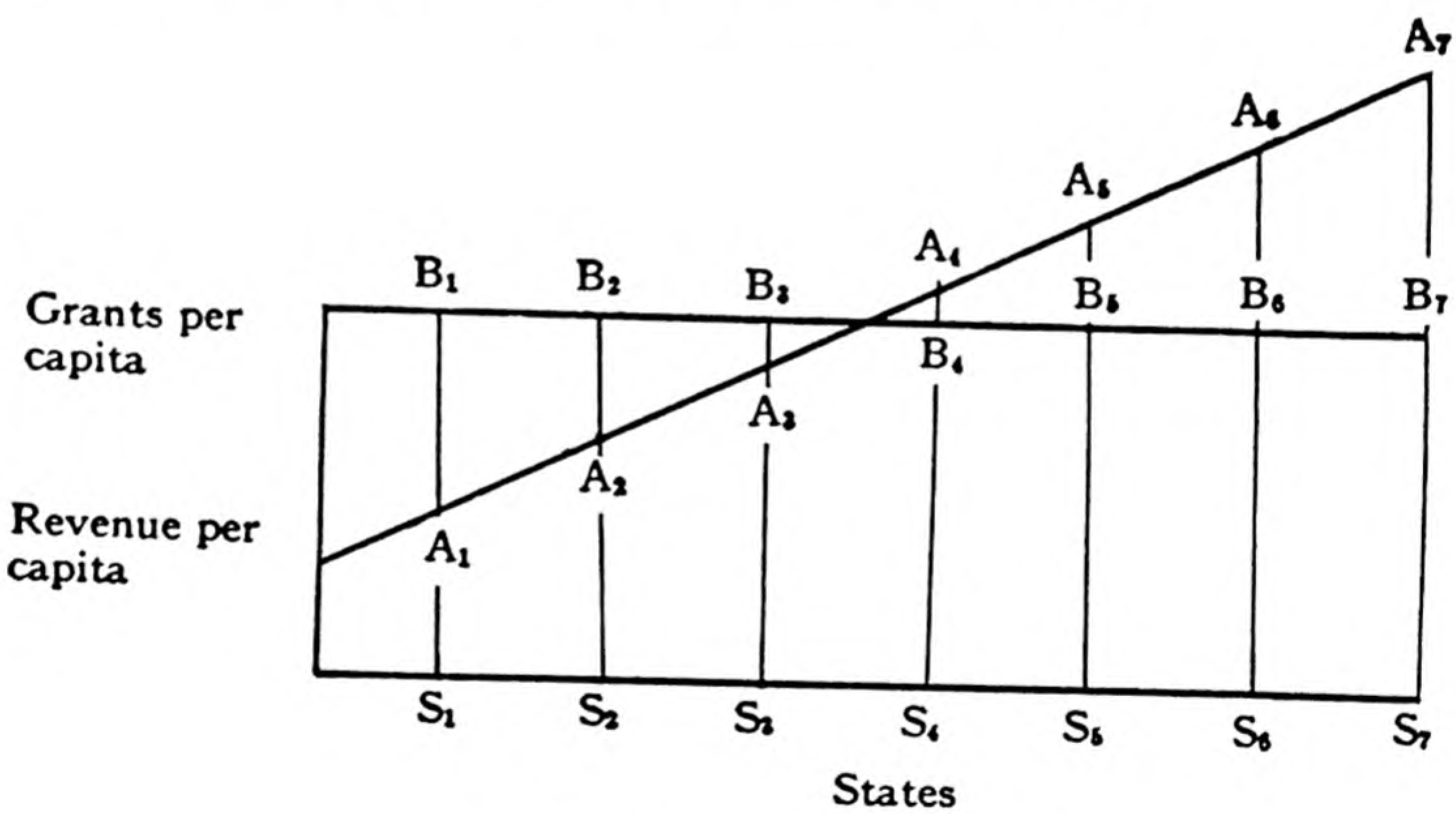


FIGURE 1

A simple diagram will illustrate the situation. The lines of equal height B_1, B_2, . . . indicate the per capita grants to, the rising lines A_1, A_2, . . . the customs revenue collected per capita from, each state. At the left a state is receiving in grants S_1B_1 and paying by customs S_1A_1 per capita; and at the right a state is receiving S_7B_7 and paying S_7A_7. In such case an *all-around*

[4] It will save circumlocution if the word "state" is understood to stand for "province" as well.

increase in grants would not improve the position of the state at S_7; a *particular* increase in the grant going to it would improve its relative position, although not by an amount equal to the increase.[5] If the assumption is added that the states which are heavier importers are also poorer as measured by wealth and income, then distribution of grants, collected by customs duties and distributed according to population, will be especially burdensome (although the per capita transfer will be no larger), since the regressive taxes will fall more harshly upon the people of the poorer states.

This historical illustration is instructive on several counts. It indicates that if the federal revenue system is regressive upon the states as units, unconditional grants to the state governments distributed on the basis of population serve to make worse the position of the poorer states. This situation could be remedied either by making the federal revenue system progressive in the sense that more is taken per capita from the richer states, or by distributing the grants on some basis which gives more per capita to the poorer states.

It is equally certain, although no such clear-cut evidence can be presented, that expenditures in a federal country encounter the same sort of difficulty. The representatives of industrial states press for one type of expenditure; those of agricultural states for another. On those important functions which are clearly national in interest, action can be taken without significant distortion because of sectional bias. But about other functions concerning which the national interest is less clear, the result is often less fortunate. And even if the federal government can secure a proper distribution of expenditure with respect to functions which clearly belong to it, a proper over-all distribution of expenditures

[5] If the grant going to the state at S_7 were increased to S_7A_7 its position would be improved, although not by an amount equal to B_7A_7, since this extra grant would have to be raised in part from it and would increase its tax contribution above S_7A_7. See Report of the Royal Commission, Provincial Economic Inquiry (Halifax, 1934), pp. 218–19, where this issue is perceived, but not solved correctly.

In the example above a revenue tariff is assumed. If the tariff is supposed to be strictly protective, then the state which had bought abroad will be forced to buy in the domestic market. How much of a burden this will be depends upon whether the protected products are produced in the state or in some other area. If the protection is of no benefit to the state, then it gets no compensation. A large number of plausible assumptions come to mind, but they cannot be pursued here.

for *all* governmental functions is not thereby achieved. The functions which are a state (and local) responsibility will be provided for much more inadequately in some areas than in others. Federal intervention by grants in aid, which bring about inter-area transfers, may seem to be indicated. Again, however, care must be taken, else such grants will introduce new elements of disequilibrium.

4. Conditional vs. Unconditional Grants

The discussion just given assumed the simplest type of grant—one which was unconditional in form with no strings attached. The common type of grant in the United States, however, is conditional in that it is given subject to participation—usually 50–50—by the recipient government in specific expenditures and subject to supervision. It will be appropriate, therefore, to consider next the merits and demerits of conditional and unconditional grants.

In any country which is heterogeneous in economic development—in any federal country—grants involve inter-area transfers, and this fact in itself argues for imposition of conditions. Unless conditions are imposed the principle of financial responsibility is infringed. Revenue is raised from citizens of one area and spent by citizens of another. But against this principle must be set other factors which pull in exactly the opposite direction. The very diversity which makes for inter-area transfers makes also for a diversity of interests, and therefore the states will not be in agreement either as to the purposes for which grants should be given or as to the proper standards of expenditure. They will urge that the grants be given without strings. Moreover, the fact of state sovereignty will support such a position. The functions which the federal government may wish to aid will often have been assigned by the constitution to the states, with the result that federal conditions concerning expenditure for them will be considered as intrusion. How are these conflicting positions to be reconciled?

In Canada and in Australia a considerable opinion has developed in favor of unconditional grants, and an effort has been made to provide these grants with a logical foundation. In Australia, the Commonwealth Grants Commission has argued and recommended that grants be based upon the fiscal need of a state govern-

ment.[6] A poor state government should be put in a position to provide its people with governmental services at the approximate average of the well-to-do states, and to this end, grants supplementary to its own sources of revenue should be supplied by the Commonwealth. These are unconditional in form and can be spent as the state government prefers, but the whole financial program of the state is examined by the Commission to see that the expenditure of the claimant is as frugal as that of its more fortunate neighbors. The claimant state can, besides, tax as it prefers, but again the Commission measures the relative severity of its system of taxation.

In Canada also suggestions have recently been made by a Royal Commission for reform of the unconditional subsidies. A provincial government is to be given a subsidy when it "cannot supply average standards of certain specified services without greater than average taxation." [7] The services which are to be the "yardsticks" represent about three-quarters of the expenditures to be left with the provincial governments.[8]

Let us press the logic of the Australian practice and the Canadian suggestion a little further. In both countries the conditional grant is suspect as involving an impairment of state sovereignty, and as leading to quarrels over jurisdiction. State needs are different and therefore each state ought to be left free to spend according to its judgment. The implication is that there is no one common standard which it is in the national interest that all should achieve. Yet while denying the existence of a common standard, the technique used by the Australian Grants Commission and the Canadian Royal Commission *presumes* a common standard of governmental services which all the states should be made able to provide, a standard which in Australia is the actual level provided by the governments of the non-claimant states.

Against this charge of inconsistency there is at least a partial answer. The level of governmental expenditure for a broad range of services might be the same in several states, and yet there might

[6] See Maxwell, "Commonwealth Grants to the States in Australia," *American Economic Review,* June 1938; "Problems of the Commonwealth Grants Commission," *Economic Record,* December 1938.

[7] Canada, Royal Commission on Dominion-Provincial Relations, *Report,* Book II: Recommendations (Ottawa, 1940), p. 127.

[8] Not three-quarters of *existing* expenditures, since the Commission recommends federal assumption of provincial debt and of responsibility for all employables.

not be parallelism in the details of the services. Welfare expenditures, for example, cover a wide range, and the emphasis might be different from one jurisdiction to another even if per capita expenditures as a whole were equal. This possibility must be admitted. The very practical issue remains: What is the extent of variation which it is desirable, in the national interest, to allow and even to encourage by use of unconditional grants? Is it possible that a set of conditional grants, administered as a whole and with flexibility, might serve better?

Another defect in a technique which makes the amount of grant be determined by an average standard of services actually provided by the states (or provinces) is that no direct account is taken of the fiscal situation of the federal government. If in Australia the average social expenditure of the non-claimant states goes up (or down), the grants to the claimant states also go up (or down). Surely there is no reason why a standard so determined should coincide with the ideal level of state governmental services. An over-all national survey might disclose that the national need for extension (or contraction) of services which the state governments provided was greater (or less) than the national need for services which were provided by the federal government. Some estimate of the desirable level of state services in relation to federal services, and of state taxable ability in relation to that of the federal government would seem to be logically indicated by the approach of the Grants Commission.

In summary, then, the basic argument which stems from the more recent uses of the unconditional grant is as follows. In a modern federalism the state governments are confronted with a plethora of functions in relation to their revenues, while the federal government, able to provide for its functions by less onerous taxation, has a surplus of taxable ability. The state functions are assumed to be irretrievably theirs because of constitutional provision and because of administrative convenience. Conditional grants are ruled out and the problem is how to make the proper adjustment through use of unconditional grants. It would seem that the federal government should look at the varied needs and taxable ability of the state governments in relation to each other and to its own needs and taxable ability. Sums given as grants will entail an increase in the severity of federal taxation and improve the level of state governmental services. The states, be-

sides, will show a wide range in the level of their fiscal needs, and the grants should be adjusted so that the state with the lowest fiscal ability in relation to the desirable level for its governmental services would get the largest grant.[9]

Let us contrast this use of the unconditional grant under federalism with that sketched above for a unitary country. In the latter the unconditional grant is a mark of its homogeneity and its constitutional strength. Any function can be brought under national administration, or relegated to the localities. A national judgment can here be applied with no defect in power and with no fear that marked heterogeneity from locality to locality will make the judgment invalid. If certain functions are, for better performance, delegated to the localities, the grants given to finance them need not be specified in detail because standards and customs and needs will be about the same everywhere.

But in a federalism the unconditional grant is a sign of the heterogeneity of the country and of the constitutional limitations upon the national power. Certain functions cannot be brought under national jurisdiction and they cannot be aided directly by conditional grants from the national treasury because of state sovereignty and because uniform conditions would not be suitable from state to state. The national government may decide to give unconditional grants to enable the governments to improve the level of certain services. To get at a proper basis for the distribution of the grants it will measure, not the need of citizens for a set of state services, but the fiscal need of state governments, and this need arises out of provision of services which are not the same from state to state. In short, it is a need which cannot be particularized.

5. The Basic Problems of Conditional Grants

The conditional grant has been developed more fully in the United States than in Canada and Australia, although it has been used in all three. Like the unconditional grant it serves to bridge the gap between disparate state functions and revenues, but the more immediate motive behind most of the federal-aid measures has been the desire to stimulate state action about matters in which there was a national interest. Some state suspicion of the condi-

[9] Obviously the states at the other end of the scale might or might not get grants.

tional grant has always existed because by it aid is given to a function, which constitutionally belongs in state hands, through federal intrusion by supervision of state performance. The federal measures have usually been introduced piecemeal and in many cases it has been difficult to lay down a clear-cut and objective set of conditions and still more difficult to measure the state performance. Vocational education, for example, is not something for which it is easy to set up a uniform program to cover the multitude of situations which actually exist, and if detailed conditions are made, they will be bureaucratic and impossible of enforcement. It is, besides, obvious that the weapon of withholding the federal grant cannot easily be used against a recalcitrant state. On the other hand, federal acquiescence in state deviation from explicit conditions will undermine the whole scheme.

A really vital question is: Does any particular plan for a conditional grant presume a national homogeneity of outlook toward a function which does not exist? Heterogeneity of attitude about some things is of the essence of federalism, and if a federal-aid measure prescribes uniformity where there are deep-seated reasons for diversity, it will fail. State recalcitrance, which is certain often to be manifested for bad reasons, will in this case be founded upon good ones.

That this difficulty is real cannot be denied, but the extent of the obstacle should not be exaggerated. The needs of citizens for most governmental services—and especially for services appropriate for federal aid—are reasonably similar over the whole of the nation. Moreover, the aim of the federal government in most cases must be, not to see that a service is rendered uniformly throughout the country, but only to establish a national *minimum* standard. There will, therefore, be room for considerable diversity of performance from state to state. Again, through federal–state governmental coöperation, flexibility in conditions can be worked out so that some diversity in state provision even of the minimum standard will be acceptable.

There are, however, two other acute and related problems connected with the conditional grant. These are the selection of the activity to be aided and the basis of distribution of the aid. Obviously the unconditional grant entirely avoids the former of these problems, since the state is left free to use the money as it sees fit. If the diversity of state governmental needs is stressed, this will

seem to be a desirable plan, and the major problem to solve is what should be the amount and basis of the distribution. The conditional grant, on the other hand puts a premium upon state performance of certain activities, since a dollar of state money spent in some ways draws in another dollar (more or less) from outside. It is this factor which has sometimes excited the energies of pressure groups who advocate particular measures without regard to the whole federal–state fiscal position or the fiscal position of particular states. When one federal-aid measure, relating to some one type of social welfare, is passed, the effect is to elevate the financial provision made for it above other types. If a state government had reached a rational revenue–expenditure distribution before the federal aid became effective, this is now completely distorted because of the greater utility given to a dollar spent in a particular direction. In short, the effect is to aggravate the disequilibrium in the revenue–expenditure relationship which is always inherent in a federal country.

The basis for the distribution of most conditional grants has usually been some measure of state need for a particular service. Sometimes it is relatively easy to find a measure of specific need, as when, for example, pensions are given to citizens over sixty-five years of age and below a certain level of poverty. But in many instances no handy criterion is available, and the federal government has often fallen back upon the basis of population because this was objective and, in some sense, a reflection of the general needs of a state for a service. In recent proposals the "equalizing" grant has received attention, but whatever its merits, it does not meet the objection raised above.

If the federal government is to use the conditional grant as an important fiscal instrument, it is eminently desirable that the piecemeal approach be modified. The existing grants should be integrated, and any advance ought to be along a broad segment of the field instead of by pushing ahead sharply into narrow sectors. The grants should be thought of as a coördinated whole and they should be framed and administered as a national plan. If this were done, the distortion which now arises out of selection of particular services for the receipt of grants would be reduced, flexibility would be introduced into the whole and, in place of the many measures of particular needs, a broad general measure of state needs could be used. The diversity among the states makes

unsatisfactory very many restricted measures of particular needs. If, as is reasonable, social services are the most important activities which the federal government will wish to assist, it might be desirable to have a social-service grant distributed with a minimum of conditions and on a basis of state fiscal need.

In the future an important problem of federalism would appear to be the coöperative administration of many functions. Even when legal jurisdiction over functions can be clearly demarcated, actual administration cannot be satisfactory without coöperative methods. If the system of conditional grants were looked at as a whole, it would probably be found that many of the difficulties in their operation could be solved. Certainly the expansion of federal aid schemes in piecemeal and haphazard fashion is bound to aggravate the divisive elements which are present in federalism.

It is, therefore, possible to reconcile the fiscal dilemma of a federalism. Admitting that a diversity of standards exists among the states, the federal government can provide conditional grants which aim at bringing state performance of important functions—especially welfare functions—to a *minimum* level. Admitting further that inter-area transfers call for imposition of conditions, these conditions can be made both effective and palatable by grouping together a series of related grants, placing them under one or a few agencies, and giving the agency or agencies a broad discretion to apply the standards with flexibility. It may be, for example, that all public-works grants (including highways) should fall under the Federal Works Agency, all welfare grants under the Social Security Board, and all educational grants under the Office of Education. In these ways the ends which are sought in Canada and Australia by reform of the system of unconditional subsidies would be reached.

6. Constant-ratio and Variable-ratio Grants

So long as the federal revenue system collects relatively more from the rich than from the poor state, *complete federal assumption* of a social welfare program leads to inter-area transfers. "Need" will presumably be met uniformly on a nation-wide basis. State and local governments as such will provide no part of the expenditure, and yet the level of service will be equalized over the nation. In a poor state the payment per recipient might be

$100, and yet the incidence of the federal revenue system might place a burden of only $40 upon the taxpayers of the state. The remaining $60 would be provided as a transfer from richer states.

In the foregoing pages, reasons have been advanced why such a program of centralization must be of limited applicability in a federal country, and why grants in aid of a conditional type are a suitable device to accommodate insistent demands for partial centralization without disturbing the major distribution of constitutional powers. This also leads to inter-area transfer of resources. Suppose again a social welfare program for which a 50–50 federal grant is provided, and that the state absorbs the grant. The recipient will receive $100, of which $50 comes directly from state funds. Of the federal grant of $50, only $20 will come from the taxpayers of the state, the remaining $30 coming as an inter-area transfer. If a variable, rather than a constant-ratio, grant is assumed, so that the federal government provides $75 out of every $100 per recipient, then the direct state share is $25 and its indirect share an additional $30, leaving $45 to be provided by inter-area transfer.

In popular argument a clear understanding of the justification for any transfer is not always found. Taxing the rich states in order to assist the poor state is likened to uneconomic subsidization of an inefficient firm, and is denounced as the most insidious method of federal usurpation.[10] Crudely put, these objections have no merit, and yet behind them lies something more substantial than bad reasoning, conservative prejudice, and the shibboleth of states' rights. An inter-area transfer for purposes which bring particular benefits to individuals in particular states is contrary to the principle of financial responsibility. In some instances, however, that principle must be set aside by more important considerations. The federal government may intervene because some states, left to their own devices, cannot provide certain services in which there is an important *national* interest at a level satisfactory to the nation. Congress, with respect to these serv-

[10] "One insidious practice which sugar coats the dose of Federal intrusion is the division of expense for public improvements or services between State and National Treasuries. Whenever by that plan we take something from one group of States and give it to another group there is grave danger that we do an economic injustice on one side and a political injury on the other. We impose unfairly on the strength of the strong and we encourage the weak to indulge their weakness." President Coolidge, "The Reign of Law," Memorial Day Address, May 30, 1925, in *Foundations of the Republic* (1926).

ices, may decide to regard the nation as an entity and therefore to redistribute revenue among the states in order that a deficiency of resources in some areas may not prevent provision of a minimum level of services. When grants are used by the Congress, an equalized level of services is unlikely to occur. The rich states which so desire may use their resources to provide a level higher than a basic national minimum. The equalization which takes place is at the bottom of the scale, since a floor is provided through which provision of the services in question may not fall.

In many instances the principle of financial responsibility can be protected by setting up conditions which serve not merely to safeguard the federal expenditure, but also to see that the states themselves make a proper effort to meet their own needs. A grant system in a federal country must recognize that standards—private as well as governmental—are different from state to state. To raise particular governmental services in a poor state to an *ideal* level by grants may distort the whole social structure. Sometimes account may have to be taken of differences in costs in different areas. And finally, the drain of federal taxes is of immediate interest in a grants system.

Most federal grants have been of the constant-ratio variety by which the federal contribution is a percentage uniform for all the state governments. This does not mean that the allocation

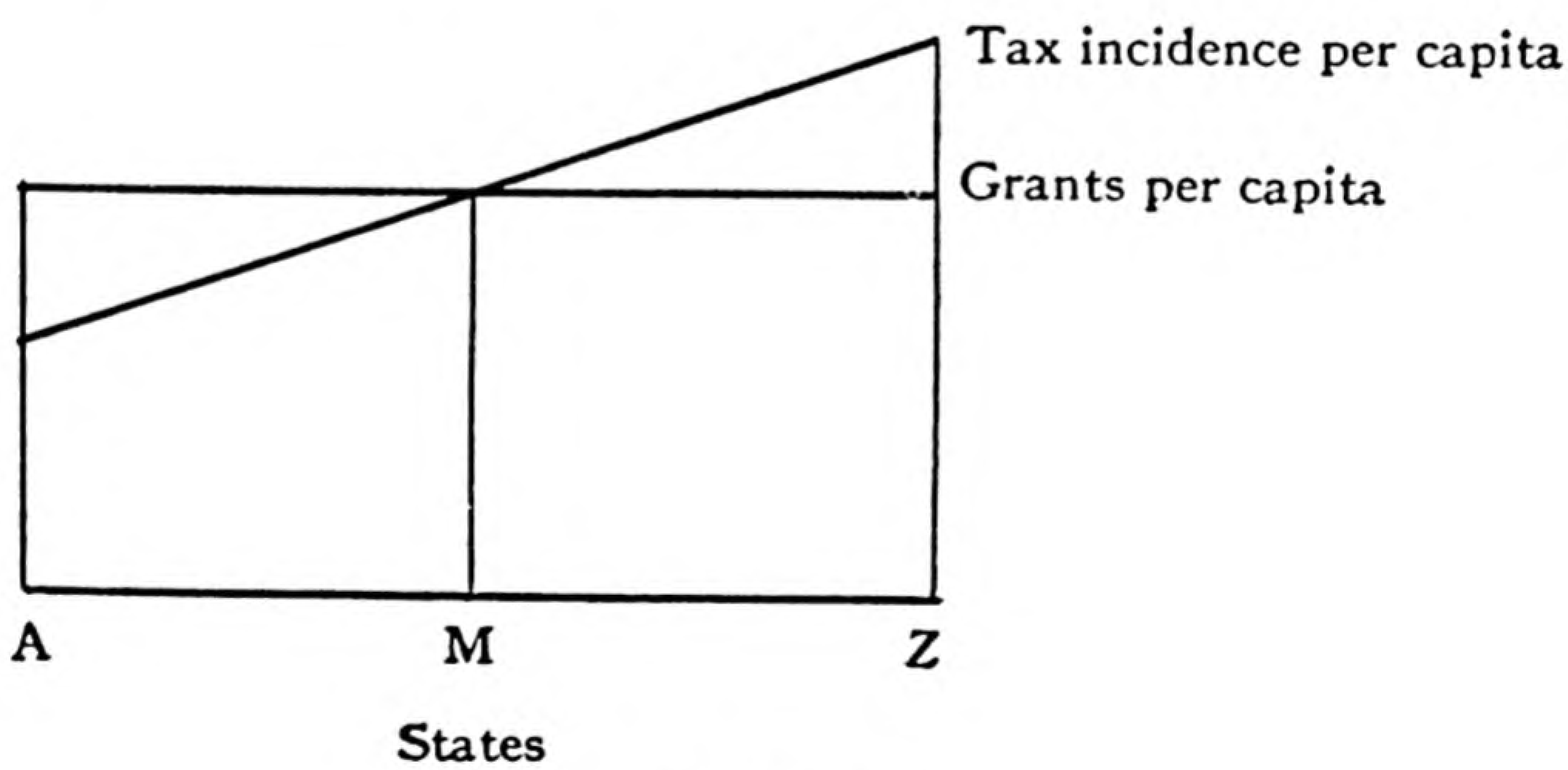


FIGURE 2

of the federal funds may not be equalizing. Suppose that the allocation is one based on population, and that the federal funds are raised in a way to take relatively more from the richer states. The accompanying diagram (Fig. 2)—supposing the states "earn"

the grants—shows that the federal drain in taxes takes more from the rich state (Z) than is returned by grants, while the poor state (A) is in the opposite situation. It is obvious also that the larger the constant percentage contributed by the federal government, the greater is the equalization, and that a 100 per cent federal grant amounts fiscally to federal assumption of a function.

A constant-ratio grant, however, when the federal share is one-half, may distort the "natural" pattern of state provision of functions. Before a grant for a specific purpose was offered, a poor state might be spending as much as it could afford for this purpose. The offer of a federal dollar for every *new* state dollar spent provides a leverage which will serve to elevate provision of this function. Such a distorting effect can be guarded against in various ways—by counting existing state expenditures as matching instead of insisting upon new state expenditures, by choosing services in which the state as well as the national interest is strong, and by aiming at a level of provision of the service which is a national minimum.

It may happen that these safeguards will be inadequate, and in recent years interest has developed in the variable-ratio or equalizing grant by which the federal government agrees to overmatch the dollars of the poor states and to undermatch those of the rich states. Most of the schemes advanced regard income payments as a basic measure of the economic and fiscal capacity of the states, as well as of their relative ability to participate in a program.[11] This general premise is acceptable, although it is recognized that the measure calls for refinement, particularly so as to take account of the *distribution* of income within each state. Moreover, the federal drain—that is, federal tax withdrawals—has to be deducted from income payments in order to reach a fair measure of state capacity. This same question may be approached in a different way. If the federal revenue from which grants are provided drains relatively more from the rich state, and if the grants themselves are distributed so as to favor the poor state, then a double process of equalization and interstate redistribution takes place. Equalizing grants, therefore, should

[11] P. Studenski, *Measurement of Variations in State Economic and Fiscal Capacity,* Social Security Board, Bureau of Research and Statistics Memorandum no. 50 (March 1943); P. H. Wueller, *Elements of a Variable-Grant Formula,* same series, no. 54 (November 1943).

be framed with the federal drain in mind; and since in fact the distribution of the federal drain is difficult to calculate, the practical conclusion is that equalizing or variable-ratio grants should not have too wide a range of ratios. This conclusion is reinforced by the fact that complete objectivity with respect to variable grants is not possible, and that marked departure from the standard of a constant ratio will arouse the animosity of the richer states. If a variable-ratio program brought political intervention on an enlarged scale—that is, if the ratio for the different states were determined by political bargaining—the harm so introduced would exceed the gains.

With these qualifications, it is desirable that use of the variable ratio in the system of federal grants be extended. Let us assume that a social service is already receiving federal grants on a constant-ratio basis. The first step should be for the Congress to decide what is the minimum national provision of the service which is to be achieved. It might, for example, decide

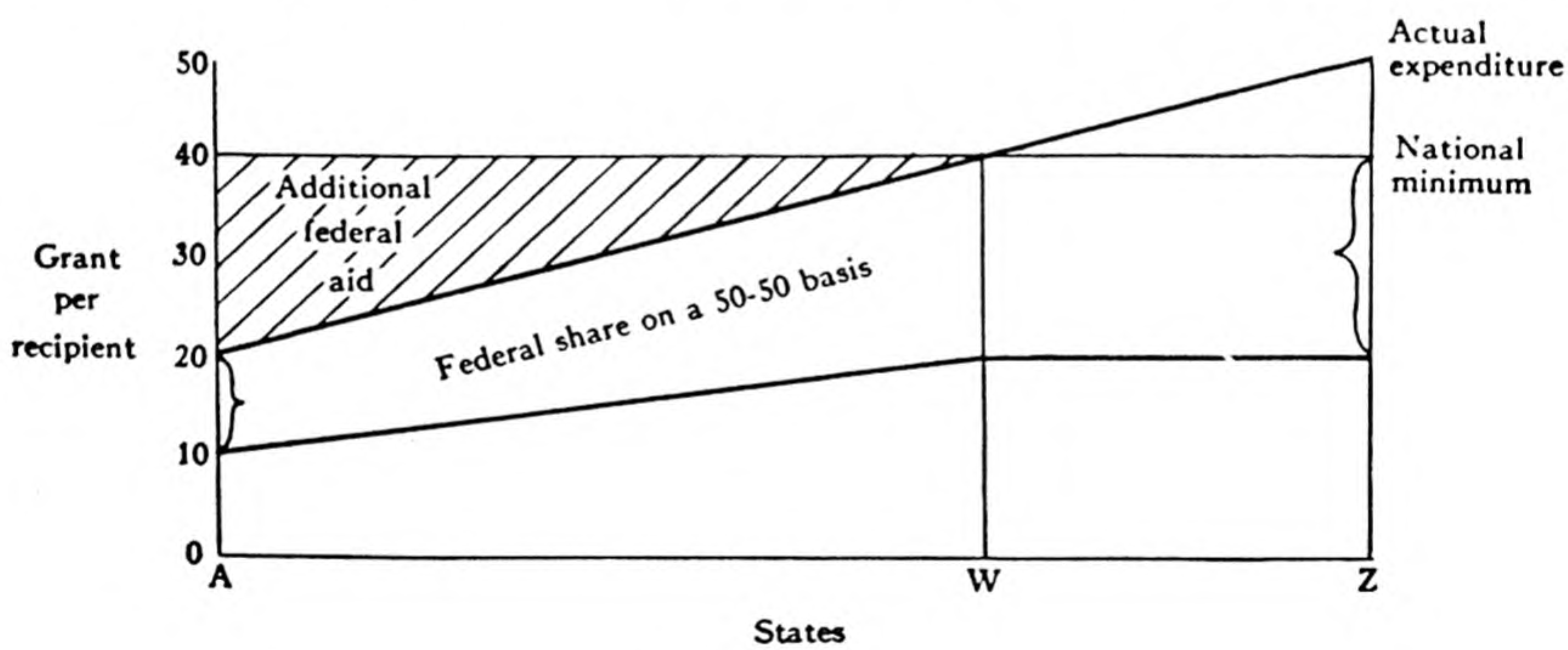


FIGURE 3

that a minimum annual expenditure of $40.00 per participant in a given program was desirable.[12] The rich states would have achieved this level, and some of them would have gone beyond it. Figure 3 illustrates the situation. State A pays $20 per recipient, of which the federal government pays one-half. State W pays

[12] In this argument the tacit assumption is made that the minimum program would be at the same level in all states. It might, however, be wise to permit different minimum levels to be set to take account of such factors as differences in cost from state to state. Extension of this variation should, however, be narrowly restricted, since allowance for differences in state standards would destroy the foundations of the idea of a national minimum.

$40 and state Z $50, the latter going beyond the national minimum. Obviously the additional federal share which should be assumed is represented by the shaded area. An increase in the federal ratio to 75 per cent for state A and of lesser ratios down to 50 per cent is indicated.[13]

Numerous other methods of setting up a variable-ratio schedule might be developed. The particular method is a matter for technical study with a view to administrative and political convenience.[14]

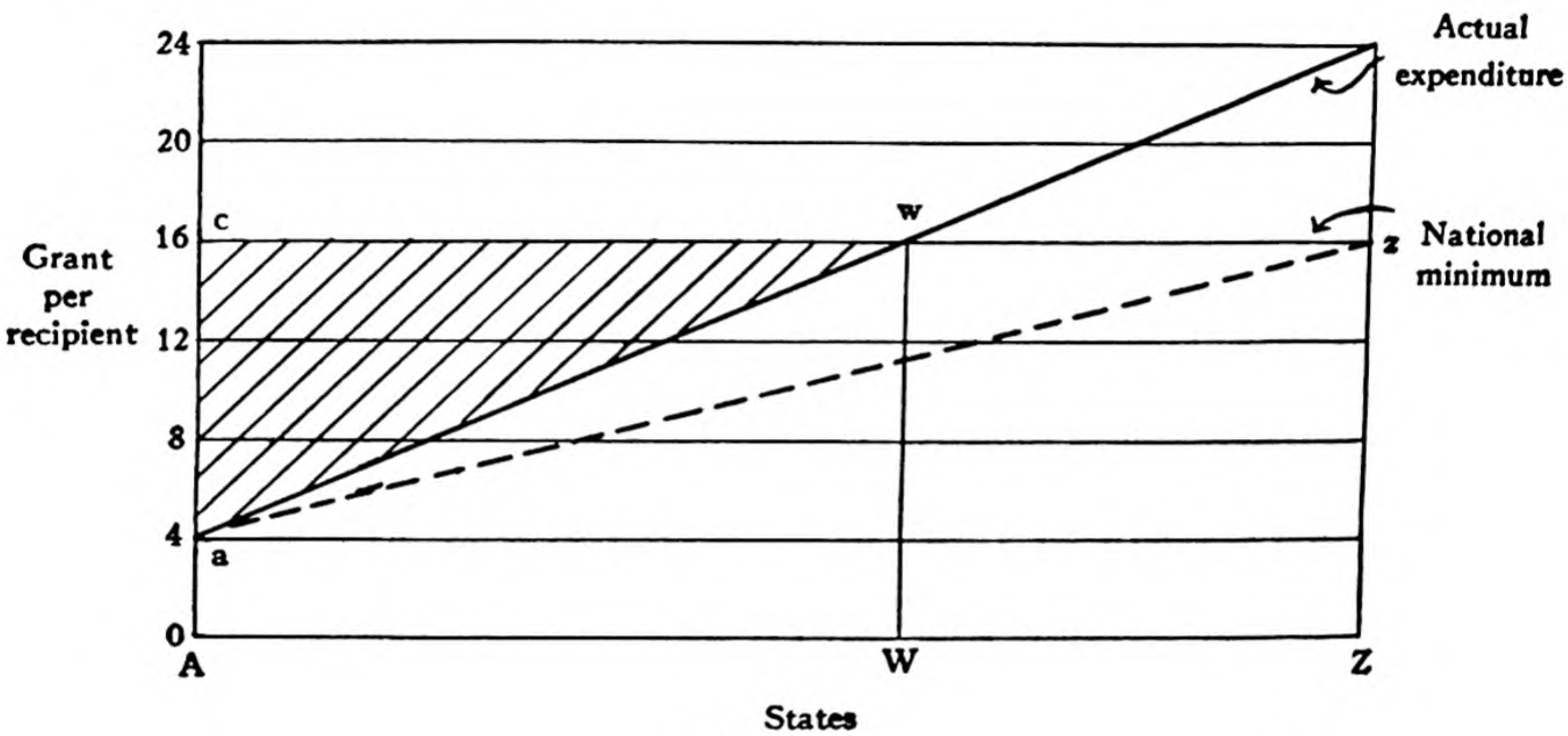


FIGURE 4

As one other illustration, let us assume that the federal grant is new, and that it is for a purpose, such as general education, in which the rich states have achieved, as the poor have not, an acceptable national minimum standard. In Figure 4 the shaded portion (awc) might appear to represent the indicated amount of the federal grant, with the federal share running from 75 per cent for state A to nothing for state W and for states in a better position. In fact, political and other reasons mentioned above would indicate that the federal grant might well be the area azc, so that all states would secure some federal grant.

7. Existing Pattern of Grants

Let us look next at the actual pattern of existing federal grants in relation to per capita income and the incidence of federal taxa-

[13] The argument assumes that each of the poorer states is making payments for the service commensurate with its fiscal capacity.

[14] David S. Gerig, Jr., "Formulas for Variable Federal Grants-in-Aid," *Social Security Bulletin,* June 1940, pp. 3–14.

tion, presuming that per capita income payments are a good test of the capacity of the states. The chart and table following show income payments for 1941 and the incidence of federal taxes for 1940.[15] A high degree of relationship is disclosed with the high-income states in general bearing a relatively large, and the poor states a relatively small, share of federal taxation. When the relationship is measured by Spearman's formula, a value of + .95 is secured (the highest per capita figure being given a rank of 1 and the lowest a rank of 48).

The relation between grants and income is, on the other hand, quite loose. An inverse correlation, with a state which ranks high in income ranking low in grants, is found for such states as New Jersey, New York, Illinois, Maryland, Rhode Island, Connecticut; and similarly some states low in income rank high in grants—South Dakota, New Mexico, Oklahoma. But for many states the relationship is just the opposite, with states high in income high also in grants—Nevada, Wyoming, Colorado, California, Washington, Oregon; and states low in income low in grants—Alabama, Mississippi, Louisiana, Kentucky, Virginia, North Carolina, Tennessee, Georgia. This latter condition is clearly unfortunate. In a federalism an equalization program must be kept within narrow limits, but surely a poor state should not rank low, and a rich state high, in the relative amount of grants received by them.

When Spearman's formula is used to measure the relationship between income and grants (with the ranks being assigned so that the highest per capita figures both for income and grants are given a rank of 1), a positive value of + .31 is secured.

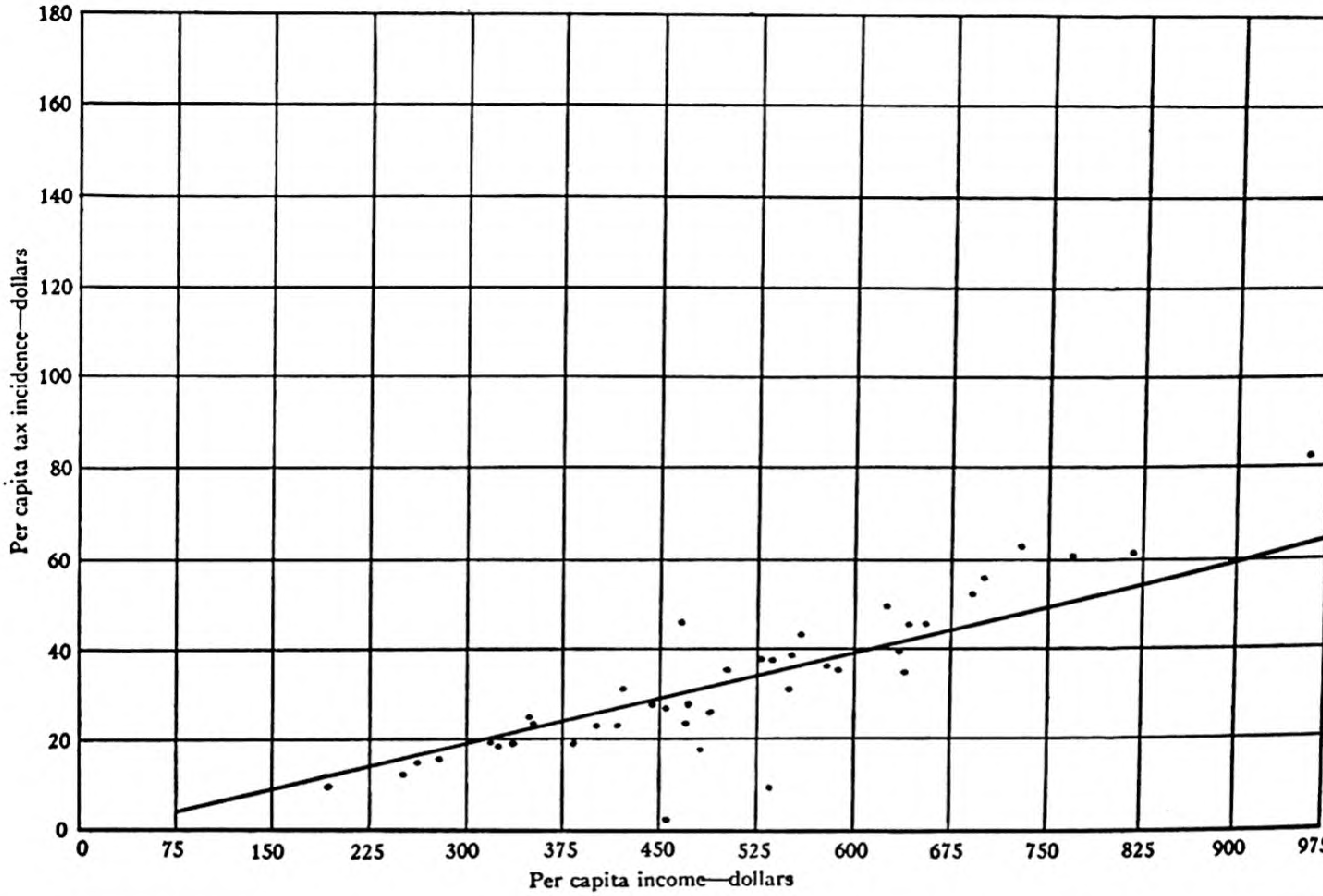
In the table below are shown the values obtained by correlating per capita income and per capita grants for the principal purposes:

Total federal aid	+.31
Employment security	+.89
Public assistance	+.41
Education[16]	+.01
Highways	−.11
Health	−.39

[15] The assumptions underlying the figures of incidence are explained in U.S., 78th Congress, 1st session, Senate Document No. 69, *Federal, State and Local Government Fiscal Relations*, pp. 207–08. The figures given here are taken from p. 219.

[16] Includes grants for vocational education and rehabilitation, defense training, colleges for agricultural and mechanical arts, state marine schools, agricultural experiment stations, and agricultural extension work.

COMPARISON BY STATES OF PER CAPITA TAX INCIDENCE (1940) WITH PER CAPITA INCOME (1941) AND PER CAPITA FEDERAL GRANTS (1941) WITH PER CAPITA INCOME (1941)



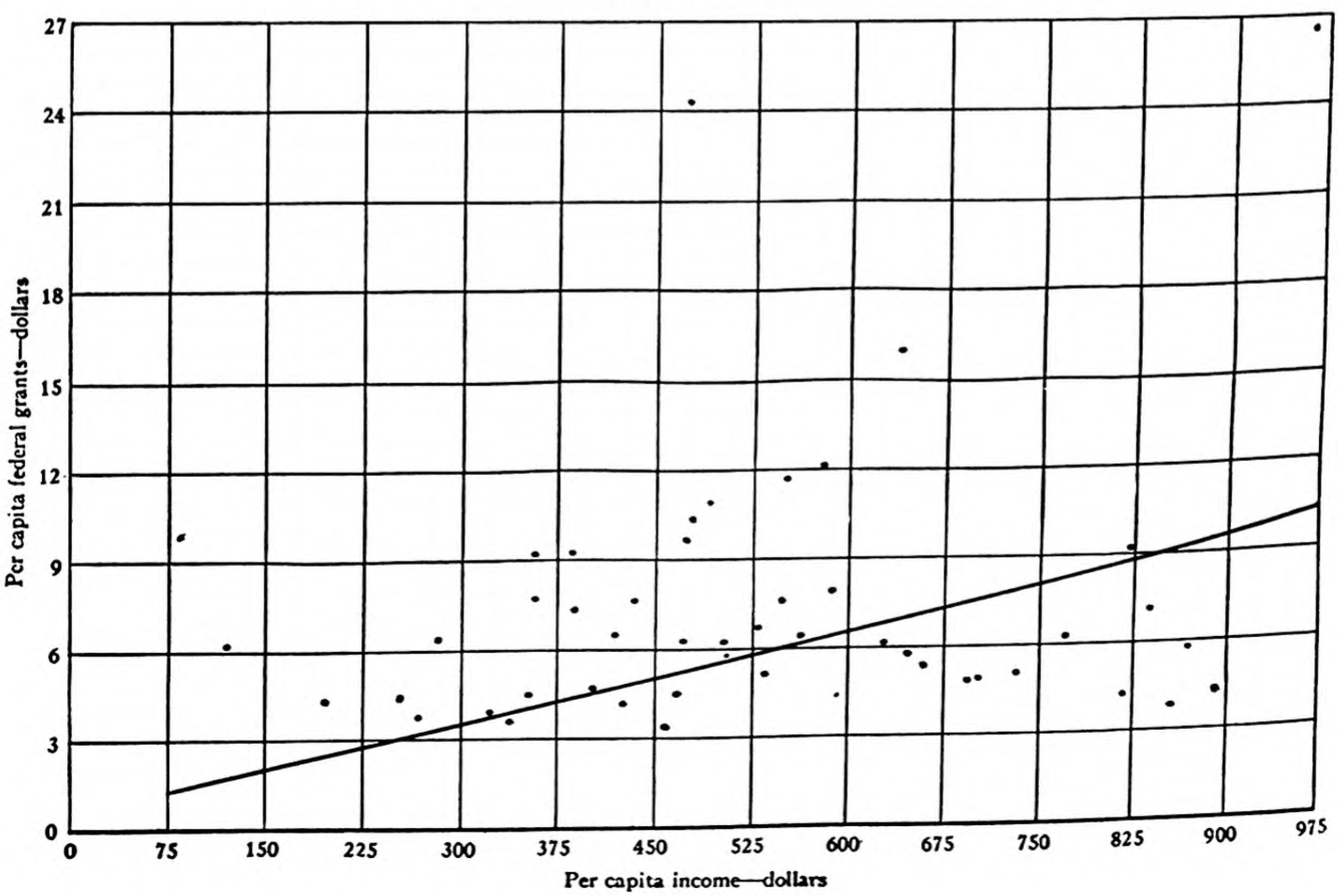


CHART 1

TABLE 39

PER CAPITA INCOME PAYMENTS IN 1941, INCIDENCE OF FEDERAL TAXES IN 1940, AND FEDERAL AID IN 1941, BY STATES

(Ranks in parentheses)

State	Per capita income 1941	Tax incidence 1940[a]	Federal aid 1941[b]
Nevada	960 (1)	83 (2)	26.51 (1)
Connecticut	864 (2)	75 (4)	5.90 (28)
New Jersey	852 (3)	60 (8)	3.95 (43)
Delaware	836 (4)	172 (1)	7.21 (19)
California	819 (5)	62 (7)	9.20 (10)
New York	814 (6)	82 (3)	4.33 (40)
Massachusetts	757 (7)	61 (6)	6.46 (21)
Rhode Island	730 (8)	63 (5)	5.18 (32)
Maryland	703 (9)	56 (9)	4.97 (33)
Illinois	691 (10)	53 (10)	4.88 (34)
Michigan	656 (11)	46 (13)	5.43 (30)
Ohio	644 (12)	46 (14)	5.80 (29)
Wyoming	638 (13)	35 (25)	17.09 (2)
Washington	633 (14)	39 (18)	9.05 (11)
Pennsylvania	624 (15)	50 (11)	6.11 (26)
Oregon	586 (16)	36 (23)	8.05 (12)
Montana	579 (17)	37 (21)	12.14 (3)
New Hampshire	560 (18)	43 (15)	6.51 (20)
Colorado	551 (19)	39 (17)	11.85 (4)
Indiana	551 (20)	32 (26)	6.12 (25)
Vermont	542 (21)	36 (24)	7.57 (15)
Wisconsin	537 (22)	38 (19)	5.24 (31)
Minnesota	526 (23)	38 (20)	6.80 (18)
Maine	504 (24)	40 (16)	5.88 (28)
Missouri	499 (25)	36 (22)	6.17 (24)
Utah	487 (26)	26 (32)	11.02 (5)
Arizona	478 (27)	31 (27)	10.43 (6)
Iowa	471 (28)	28 (30)	6.42 (22)
Idaho	470 (29)	24 (34)	9.65 (7)
Florida	465 (30)	46 (12)	4.56 (36)
Virginia	455 (31)	27 (31)	3.54 (48)
Nebraska	444 (32)	28 (29)	7.79 (14)
Texas	422 (33)	31 (28)	4.27 (41)
Kansas	418 (34)	23 (37)	6.63 (9)
West Virginia	401 (35)	23 (36)	4.70 (35)
North Dakota	385 (36)	21 (39)	7.38 (16)
South Dakota	384 (37)	20 (41)	9.30 (8)
New Mexico	356 (38)	22 (38)	9.20 (10)
Oklahoma	354 (39)	23 (35)	7.82 (13)
Louisiana	350 (40)	25 (33)	4.48 (37)
North Carolina	335 (41)	19 (43)	3.66 (47)
Kentucky	330 (42)	20 (40)	3.90 (45)
Tennessee	325 (43)	19 (44)	3.99 (42)
Georgia	321 (44)	19 (42)	3.94 (44)
South Carolina	281 (45)	16 (45)	6.40 (23)
Alabama	264 (46)	15 (46)	3.87 (46)
Arkansas	253 (47)	13 (47)	4.46 (38)
Mississippi	195 (48)	10 (48)	4.33 (40)

[a] U.S., 78th Congress, 1st session, Senate Document No. 69: *Federal, State and Local Government Fiscal Relations*, p. 219.

[b] U.S. Department of Commerce, *Federal and State Aid*, 1941, p. 32.

By all odds the most important grants in terms of amount are those for public assistance, making up nearly half the total. These grants distort the whole distribution, since their tendency is to provide larger relative amounts for the richer states. The grants for education are, in this respect, a little better. Those for public health, however, are equalizing in their effect. Through them the poor states, on the average, secure relatively more than do the rich states.

But while federal grants as a whole, and the most important types of grants, fail to be equalizing when examined by themselves, a full evaluation is possible only by relating this result to federal-tax incidence by states. This can most easily be done by calculating regression lines for (1) per capita income and federal aid by states, and (2) per capita income and federal-tax incidence by states. To facilitate comparison the figures for tax incidence are reduced so that the average per capita is equal to the average per capita aid.[17] The regression equations are as follows:

Where X = per capita income by states
Y = per capita taxes by states
$Y = -2.85 + .0151X$

Where X = per capita income by states
Y = per capita aid by states
$Y = 2.98 + .0078X$

When these lines are plotted (Chart 2) it is clear that the slope of the tax curve is steeper than that of the aid curve, indicating equalization despite the fact that the distribution of grants by themselves is not equalizing.[18] In short, the unequalizing distribution of the grants is more than offset by the distribution of the tax incidence.

That the relationships are, however, haphazard, and that manifest inequities inhere in the distribution, can be brought out by

[17] Implicitly this argument assumes that grants are financed from federal tax revenues as a whole, rather than from particular taxes. The clear exception is grants for employment security which are provided by payroll taxes.

[18] In this graph the tax figures have been reduced so that their average per capita is equal to the average per capita aid. Further to facilitate graphic comparison, the scales on the ordinates are arranged so that the average of the per capita grants by states and the average of the per capita incidence by states are of equal height. These two averages in themselves have, of course, a doubtful statistical meaning.

PER CAPITA FEDERAL GRANTS (1941) AND THE INCIDENCE PER CAPITA OF FEDERAL TAXES (1940) IN RELATION TO PER CAPITA INCOME (1940) BY STATES

x = Taxes to income; o = Grants to income

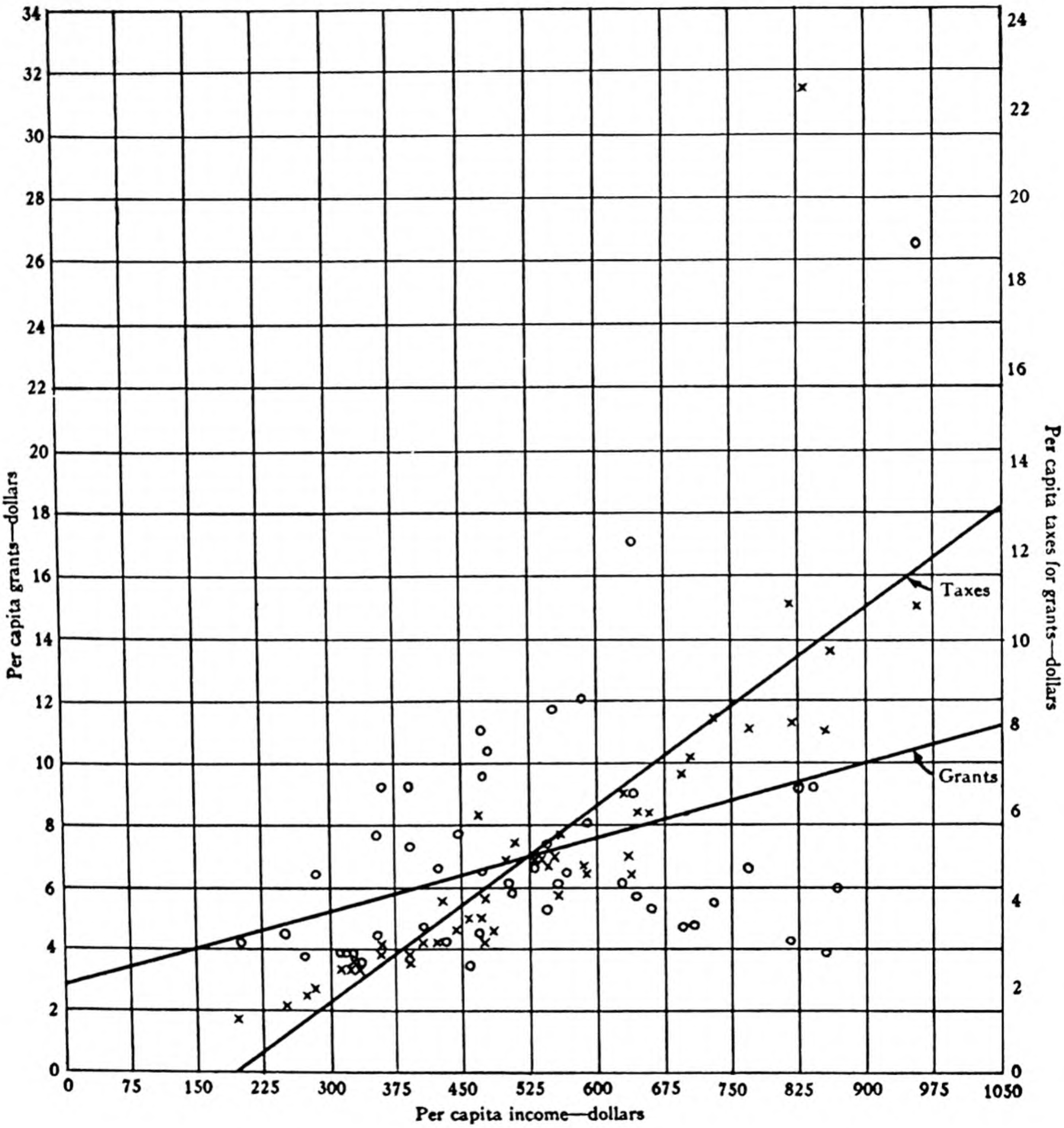


CHART 2

examination of Tables following. In Table 40 the figures of per capita taxes and grants are shown as relative numbers on a base of 100. Tables 41 and 42 show, in terms of *rank* the ten states which most clearly are advantaged, and the ten most clearly disad-

TABLE 40

Relative Per Capita Federal Aid and Tax Incidence
(Ranks in parentheses)

State	Relative per capita federal aid, 1941	Relative per capita tax incidence, 1940	State	Relative per capita federal aid, 1941	Relative per capita tax incidence, 1940
Alabama	68 (46)	34 (46)	Nebraska	137 (14)	64 (29)
Arizona	184 (6)	71 (27)	Nevada	467 (1)	190 (2)
Arkansas	79 (38)	30 (47)	New Hampshire	115 (20)	98 (15)
California	162 (10)	142 (7)	New Jersey	70 (43)	137 (8)
Colorado	209 (4)	89 (17)	New Mexico	162 (10)	50 (38)
Connecticut	104 (28)	172 (4)	New York	76 (40)	188 (3)
Delaware	127 (19)	393 (1)	North Carolina	64 (47)	43 (43)
Florida	80 (36)	105 (12)	North Dakota	130 (16)	48 (39)
Georgia	69 (44)	43 (42)	Ohio	102 (29)	105 (14)
Idaho	170 (7)	55 (34)	Oklahoma	138 (13)	53 (35)
Illinois	86 (34)	121 (10)	Oregon	142 (12)	82 (23)
Indiana	108 (25)	73 (26)	Pennsylvania	108 (26)	114 (11)
Iowa	113 (22)	64 (30)	Rhode Island	91 (32)	144 (5)
Kansas	117 (9)	53 (37)	South Carolina	113 (23)	37 (45)
Kentucky	69 (45)	46 (40)	South Dakota	164 (8)	46 (41)
Louisiana	79 (37)	57 (33)	Tennessee	70 (42)	43 (44)
Maine	104 (28)	91 (16)	Texas	75 (41)	71 (28)
Maryland	87 (33)	128 (9)	Utah	194 (5)	59 (32)
Massachusetts	114 (21)	139 (6)	Vermont	133 (15)	82 (24)
Michigan	96 (30)	105 (13)	Virginia	62 (48)	62 (31)
Minnesota	120 (18)	87 (20)	Washington	159 (11)	89 (18)
Mississippi	76 (40)	23 (48)	West Virginia	83 (35)	53 (36)
Missouri	109 (24)	82 (22)	Wisconsin	92 (31)	87 (19)
Montana	214 (3)	85 (21)	Wyoming	301 (2)	80 (25)

TABLE 41

Ten States Receiving Favorable Treatment

State	Rank in Terms of: Aid	Tax incidence	Income
Arizona	6	27	27
Colorado	4	17	19
Idaho	7	34	29
Montana	3	21	17
Nevada	1	2	1
Oregon	12	23	16
Utah	5	32	26
Vermont	15	24	21
Washington	11	18	14
Wyoming	2	25	13

TABLE 42

Ten States Receiving Unfavorable Treatment

State	Rank in Terms of: Aid	Tax incidence	Income
Alabama	46	46	46
Arkansas	38	47	47
Florida	36	12	30
Georgia	44	42	44
Kentucky	45	40	42
Louisiana	37	33	40
North Carolina	47	43	43
Tennessee	42	44	43
Texas	41	28	33
Virginia	48	31	31

vantaged by the present system. All of the former rank moderately high in terms of income, the incidence of federal taxes upon them is relatively light, and yet they have a disproportionately high rank in terms of federal aid. (One state, Nevada, provides the curiosity of a state which ranks at the top both in terms of per capita aid and in terms of income.) The reasons for this situation are to be found in those features of certain aid measures which give heavy weight to area, public-land acreage, rural and farm population. The ten states receiving unfavorable treatment are relatively poor, and they secure no suitable offset by way of a light incidence of federal taxes or a high federal aid.

Although this examination shows that the existing distribution is unsatisfactory, no ideal over-all revision can be suggested. More equalization than prevails at present should be provided, but the caution has been given that, in a federalism, a radical program of equalization, either through grants or taxation, is not feasible. With respect to the social service grants (as distinct from developmental and fiscal-control grants, such as those for highways and public works), the standard should be grants sufficient to provide a national minimum in every state.

8. Indicated Revision of Conditional Grants

Revision of conditional grants in the manner outlined in these pages obviously calls for major changes in many of the existing grants in order to weld them into a *system* of grants, and it is by no means clear that reform can rest upon alteration of the *existing* grants, since the practical obstacles to their change will be numerous. So far as they are concerned, it may be that reform will have to be restricted largely to piecemeal revisions and to seeing that no further departures from proper principles are tolerated. Progress toward a consistent system can also be made by *additions* to the grant scheme.

Let us look at some of the major grants. Probably the most hodgepodge group consists of those for special types of education —agricultural experiment stations, agricultural research, agricultural extension work, colleges for agriculture and mechanical arts, vocational education. These grants have grown up over more than half a century by accretion according to the whim of Congress and the vigor of pressure groups. It would be a significant reform if they were codified and revised with no object in mind

except that of bringing the whole to order. Beyond this it is probably impossible to go in the near future. The basis for apportionment of the grants—population—is not unsatisfactory for the purposes in question, and state and local expenditure has adjusted to the programs in most cases. The grants for vocational education are most to be criticized both in theory and administration, and many of the recommendations concerning them by the Advisory Committee on Education should be implemented.

What is desirable is the addition of grants for general education. These new grants should be variable in form, so that the poor states secure more than the rich, the criteria being per capita income and number of children of school age. Such grants should, in general, not be designed to be stimulative in nature. State and local governments, with a few dishonorable exceptions, should not be expected to increase their own educational expenditures to secure the grants. Instead they should merely maintain the present level (in some instances permission to decrease might conceivably be given), using the federal grants in a directed and orderly effort to raise the levels of their educational provision. Addition of this sort of equalizing grant could be utilized to adjust the whole pattern of federal grants. Poor states now unfairly treated could be relieved, and more equitable total distribution of federal grants could be achieved.

A second major set of grants is that for highways, and here we find a program which is comparatively orderly. The original program was designed to be stimulative in nature, and undoubtedly it has operated in this way. But no convincing case can be made for the proposition—often asserted—that overstimulation occurred. Errors have been made—particular states have planned badly both in terms of technical problems and of finance. In general, however, overbuilding has not taken place. At present the highway-aid system is being overhauled with an eye both to reform and expansion. The federal government is to assume a larger responsibility. On the one hand urban, and on the other rural, communities are to secure a larger share of grants. What has been left out and what should be put into the scheme is a counter-cyclical plan. This will not be easy. The theories of the highway engineer and of the economist have no natural affinity. The former tends to think of a non-cyclical world, and once his plans are actually ready for execution he wants expendi-

ture to go forward without regard to changes in business conditions. He must be made to appreciate that, although all highway building—all construction of public works—is not equally postponable, a considerable flexibility can be secured.

The public health grants—those under title VI of the Social Security Act, and those for venereal disease control, crippled children, maternal and child health—represent the most radical departure from the traditional pattern. The federal officers who administer these grants have been given a wide discretion in allocation, and they have used it for purposes of equalization. The program is relatively modest, and it may be doubted that Congress has appreciated the significance of the precedent. A larger program of public health is, however, in the offing, and with it will come a further opportunity to inject equalization into the whole grant system by distribution on the basis of per capita income and particular measures of need.

By far the most important grants in terms of expenditure are those for old-age assistance, dependent children, and the blind. Unfortunately these grants—especially those for old-age assistance—depart significantly from proper principles. Introduced in a period of acute depression as a social measure and with a clear design to induce state action, they succeeded only too well, and a tightly organized minority group forced many state governments, and Congress itself, into steps which aggravated the errors of the original legislation.

The old-age assistance grants were open-end grants by which the federal government promised to match state and local expenditures up to a total of $30 ($40 in 1939) monthly per recipient. No limit was set on the amount of the federal grants going to a state except through standards of eligibility. Since these standards were not applied uniformly, some states soon came to have relatively many more recipients than others. Moreover, the amount of $40 (or even $30) was beyond what many states could afford. The result has been that the grants have tended to go to the states in amounts directly related to their wealth or poverty. Some poor states, indeed, have drawn heavily in grants, the result in such cases being that old-age assistance as a governmental function received more than its reasonable share of state–local expenditures. The fault, it should be noticed, is not simply that the grants were open-end. If the federal govern-

ment had set its maximum contribution at a lower figure than $40 (or $30), the inequitable drain in grants might not have occurred.[19] The trouble is that the principle of establishing a national minimum within the range of all the states was forgotten.

It would be futile to suggest that the errors in the present setup of the public-assistance grants can be rectified by a direct approach. The more practical remedy recommended by the Social Security Board is to place the grants on a variable basis, so that a larger federal contribution is made to the poorer states.

In one other program initiated during the depression—FERA and WPA—there was a distinct bias toward distribution of federal funds in such a way as to give too much to the richer and too little to the poorer states. The reasons for this bias have been discussed earlier and the conclusion reached that, for the future, a system of grants is to be preferred both for work relief and for direct relief. Work-relief grants are primarily a matter of fiscal policy—they should be expansible in depression, and contractible in prosperity. Grants for direct relief are a matter of public welfare. Like the grants for old-age assistance, they should be set up on an equalizing basis and administered by the Social Security Board.

The argument advanced in these pages leaves no room for the unconditional grant, and current public opinion in the United States supports such an exclusion. Recent developments in Australia and Canada—both federal countries with problems which parallel those of the United States—may raise doubts that American opinion is correct. Viewed historically, Canadian and Australian experience with unconditional grants appears sterile and even sordid,[20] but the work of the Australian Commonwealth Grants Comission since 1933, and of the Canadian Royal Commission on Dominion-Provincial Relations which reported in 1940, has presented a new frame of reference. It may be that the unconditional grant has latent possibilities not to be judged by the fumbling use made of it in the past. If an over-all view of minimum national needs for important social services could be taken,

[19] It is, therefore, wrong to state that the effects of open-end matching grants are to "aggravate inequalities." *Federal, State and Local Government Fiscal Relations*, p. 167.

[20] See J. A. Maxwell, *Federal Subsidies to the Provincial Governments in Canada* (Cambridge, Massachusetts, 1937).

needs as well the fiscal capacities of individual states could be measured, and a relatively accurate revenue–expenditure equilibrium could be established by use of an unconditional grant. The problem—always present with conditional grants—of what particular service to encourage, would be eliminated. Specific needs, and the specific controls which go along with them, are not always measurable and ascertainable. All of these problems would become less acute with an unconditional grant system. The major obstacle is, however, extremely serious. The unconditional grant assumes an over-all knowledge of and attitude toward federal–state fiscal relations which is unlikely soon to be achieved.

Revenue Revision

The tax conflicts arising out of federalism in the United States have become more and more serious with each decade, and it is certain that with the conclusion of the war an impassioned debate will arise. Those who profess to speak for the states will demand that the federal government relax its hold on the very large segment of the tax field which it seized upon during the war. Others will be more eclectic and will insist simply that a thorough revision of federal–state taxation is overdue and that the existing conflicts place intolerable and uncompensated burdens upon the taxpayers and constitute a drag upon the efficient operation of our economic system.

The case for complete federal assumption of income taxation is extremely strong. Income in a nation so economically integrated as the United States is preëminently a national concept. It cannot, without great confusion, be carved up and assigned geographically to political units smaller than the whole nation. No other source of taxation is so appropriate for national use, both for the sake of equity in taxation and for the sake of fiscal productivity. The present jurisdictional division is most unhappy. Income is differently defined from state to state, and no definition can be suggested which the states would regard as fair or even acceptable. The existing conflicts in jurisdiction not only create multiple taxation, they also magnify the costs of tax compliance and tax collection. As things now stand, income is taxed on a catch-as-catch-can basis, subject only to a loose set of rules which the courts and a few farsighted state administrators impose. No substantial improvement, short of transfer, is to be expected.

The net effect is a reduction in the national income through increased business costs and impediments to a free flow of capital. That this reduction cannot be measured is no reason to doubt its importance. And in view of the prospect that government will utilize fiscal policy in order to moderate the swings of the business cycle, federal control of income taxation should be a major instrument. Through its use a significant, if indirect, governmental influence on investment and consumption might be possible.

All of the arguments which point to complete federal assumption of income taxation are duplicated when attention is given to death taxes. Equity to the individual taxpayer, administrative feasibility, the existing confusion stemming from recent judicial decisions, all point to the conclusion that death taxes should be under federal authority. It happens, however, that the crediting device is now applicable to death taxes, and although so far this has accomplished little, competent opinion holds that it can be made an effective instrument for reform. The Special Committee on Intergovernmental Fiscal Relations believed that the credit "can be remodeled to accomplish much wider objectives than those which were contemplated in the original effort." [21] This remodeling would involve graduation of the credit and assumption by the federal government of the right to determine "domicile and distribution of those estates which are interstate in character." [22] Reform along these lines is worth trying because it appears to be less disturbing than complete federal assumption. In a federalism progress is not made by jumps, and precedent is an invaluable confederate.

In the field of commodity taxation the advantages of federal, as compared with state, administration are much less impressive. The general sales tax, particularly as it affects interstate commerce, is not handled satisfactorily by some states, and federal intervention by legislation which authorizes nondiscriminatory state taxation of sales in interstate commerce should be considered. If this were achieved, the states could be left in full and effective possession of the tax.

Concerning taxation of gasoline, tobacco, and liquor, no single answer can be given. Gasoline taxation, however, should be left in state hands, with federal withdrawal as part of a post-war re-

[21] *Federal, State and Local Government Fiscal Relations*, p. 15.
[22] *Ibid.*, p. 495.

vision of federal–state fiscal relations. State administration of the tax is reasonably successful, and existing faults are not beyond the possibility of remedy by coöperative action.

State taxation of tobacco products is much less successful—as well as much less widespread. The federal government, however, taxes tobacco products with relative efficiency. As part of an over-all revision of federal–state fiscal relations, the best plan would be federal collection and state sharing of this sort of taxes. The basis for the sharing—consumption or population (weighted or unweighted)—must be a matter for negotiation, since no convincing case can be made for any one basis apart from political considerations.

State taxation of liquor since repeal has also been unsatisfactory. The states, in haste to secure revenue and to provide protection for producers within particular state borders, passed discriminatory legislation unhampered by the commerce clause; and the federal government set them no statesmanlike example. Looking to the future, however, liquor taxation might well become principally a state source of revenue. Agreement should be reached by which the states would eliminate discriminatory taxes, and the federal government could facilitate this agreement by making it a condition to its gradual retirement from the field. If, in addition, the states were to move toward the so-called monopoly system, a satisfactory revenue could be secured, and a considerable divergence in prices and social controls could be maintained.

In the foregoing pages an extensive program for adjustment of federal–state fiscal relations has been advanced, involving shifts in sources of revenue and in responsibility for governmental functions, particularly by enlargement of federal grants. The program follows the middle of the road; it recognizes the inherent federalism of the United States; and it affirms the belief that the problem of federalism, "adequately stated, is not so much a question of division of powers as it is a question of division of labor." [23] The worn-out issue of states' rights versus a strong federal government is, as a modern statesman has said, not an issue, it is a relic.[24]

[23] Walter Thompson, *Federal Centralization* (New York, 1923), p. 380.
[24] Wendell L. Willkie as quoted in the *New York Times*, June 12, 1944.

This relic has not, however, lost its efficacy. The program will be viewed by the states'-rights group as coercive, and the question comes to mind how it, or any similar program, can make progress. The forces which oppose change in governmental relations are now and, except for odd moments of history, are bound to remain, in a strategic position. Down the years they have been forced to retreat, but they have fought many successful rearguard actions.

The difficulty of reform is made greater by the fact that the program has a certain unity. It would, for instance, be absurd to advance in isolation the proposal that the federal government be given the exclusive right to tax income, or in reverse that the states be given the exclusive right to tax gasoline or liquor. Grant-in-aid measures are, indeed, more susceptible to a one-thing-at-a-time approach, and in the past pressure groups have launched them by stressing the unique importance of their particular schemes. And this need not lead to bad results. Even if Congress had an ideal over-all view of the fiscal problems of federalism, and even if it were buttressed by adequate and unbiased information, only a certain number of measures could be enacted in any given legislative period. At any given time only a limited number of schemes are marginal. In fact, of course, Congress does not often have unbiased information. With the best will in the world it cannot unerringly select the right schemes. It needs technical assistance, and it needs the support of an informed public opinion.

Many students of federal–state fiscal relations have appreciated these problems and have proposed remedies. Recently the Special Committee on Intergovernmental Fiscal Relations recommended that a Federal–State Fiscal Authority be created to promote close collaboration among federal and state administrators, to facilitate interstate coöperation, to conduct research, etc.[25] The committee in general favored the "nibbling" approach by which piecemeal attention would be directed at individual abuses, and it was skeptical of the value of "grandiose" plans for fiscal coördination. Beyond a doubt this is the way that progress is most likely to be made. It is, however, extremely unsatisfying and it is a second-best choice. Possibly the proposal for a Fed-

[25] Report, p. 5.

eral–State Fiscal Authority is so undramatic that it may not escape the oblivion which has swallowed up prior proposals.

In Canada and Australia, the two other English-speaking federalisms, marked progress has been made in the past decade at revision of intergovernmental fiscal relations. It is an error to allege that their example holds no lessons for the United States. The parallelism between their problems and those of the United States is, of course, incomplete, but it is also striking. The generalization is ventured here that the principal explanation of the more serious consideration given to questions of intergovernmental fiscal relations in Canada and Australia is to be found in the relative disparity of their fiscal resources. Canada and Australia are rich countries, but they are not so rich as the United States, and during the difficult 1930's stresses and intergovernmental frictions, which were tolerable in good times, became intolerable. Grave investigations were made, and these investigations were conducted with such authority and skill that their recommendations commanded public and governmental attention.

Cannot the same course be pursued in the United States? Is it not an important part of post-war planning to overhaul federal–state fiscal relations? Nothing will be achieved by research alone. Research will be necessary, but above all else the investigation must be carried out by leaders of national reputation who carry authority and who command public respect. And any attempt at balancing of federal and state membership on the investigating group should be shunned. Sections and states must be heard, their claims must be appraised, their problems cannot be neglected. But the job of the men who may be appointed is to give advice to the nation; their answers should be national answers, devoid of partisanship and sectionalism.

The weight of advantage, therefore, points to a bold approach which seeks a thorough and over-all solution, combining many elements. In a real sense the problem is multilateral, requiring simultaneous handling of all its aspects. Each state should be made to see the whole of the part which it will play, compared with the parts of all the other states. Such a broad approach should capture the national imagination, gather national support, and dissipate the strength of minority pressure groups. If carried through to success, it will vitalize our federalism, increase the national income, and strengthen democratic government. In this

way, rather than by blind opposition to every measure which increases the federal authority, will the threat of overcentralization be checked. James Madison hit upon the nub of the matter more than a century ago. "If," he said, "the people should in the future become more partial to the federal than to the state governments, the change can only result from such manifest and irresistible proof of better administration, as will overcome all their antecedent propensities, and in that case the people ought not surely to be precluded from giving most of their confidence, where they may discover it most due." [26]

[26] Quoted by T. V. Smith, "States Rights and the Rights of the States," *State Government*, February 1940.

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